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In the Supreme Court of the United States October Term, 1996

DOUGLAS R. PRINCE and
JANE PRINCE,

Petitioners,

v.

UNSECURED CREDITORS COMMITTEE,

Respondent.

Petition For Writ of Certiorari To The
United States Court of Appeals For The Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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69 pp

QUESTIONS PRESENTED

1. Did the Court of Appeals err in holding that good will of a professional is the property of his professional corporation and not within the future earnings exception under 11 U.S.C. §541 (6) excluding it from property of the bankruptcy estate?

2. Did the Court of Appeals err in ignoring state law as it applied to good will being income generating ability and there being no implied covenants in determining that good will including that under a covenant not to compete were the property of the bankruptcy estate?

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Petitioners, Douglas R. Prince and Jane Prince, respectfully pray that a Writ of Certiorari issue to review the Judgment entered by the United States Court of Appeals for the Seventh Circuit on May 31, 1996, and the subsequent denial of the petition for rehearing and suggestion for rehearing en banc on July 9, 1996.

OPINIONS BELOW

The opinion of the Court of Appeals for the Seventh Circuit is reported at 85 F. 3d 314, and is reprinted in the appendix.

The decision of the United States District Court for the Northern District of Illinois is reported at 127 B.R. 187 and is reproduced in the appendix. The bankruptcy court decision is not reported and is reproduced in the appendix.

JURISDICTION

The date of the judgment sought to be reviewed was entered on May 31, 1996.

The date of the order respecting rehearing was entered July 9, 1996.

The statutory provision believed to confer on this Court jurisdiction to review on a writ of certiorari the judgment in question is 28 U.S.C. §1254(1).

STATUTE INVOLVED

11 U.S.C. 541 as follows:

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> * * * * * *
>
> (6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an

individual debtor after the commencement of the case.

STATEMENT OF THE CASE

Dr. Douglas R. Prince, an orthodontist, and his wife Jane Prince filed a petition in bankruptcy under Chapter 11. A plan of reorganization was filed and accepted by the creditors and the court. Under the plan the Princes as debtors were to marshall the equity value of all assets into a creditors fund either by sale of the assets or by deposit of the equity value by the debtors in the creditors fund if the asset was retained. One of the assets of the estate was 100% of the stock in a one orthodontist professional corporation. The plan provided that if the debtor and creditors were unable to agree on the value thereof, a valuation hearing would be held.

There was lack of agreement as to the value of the stock in the professional corporation and a valuation hearing was set.

Prior to the valuation hearing, but after confirmation of the Chapter 11 bankruptcy plan, Dr. Prince sold the stock in the professional corporation plus a covenant not to compete plus some services to another orthodontist for $450,000 or $500,000 depending on the interest rate.

At the valuation hearing it was pointed out that Dr. Prince was the only orthodontist in the orthodontic practice conducted by the professional corporation. Dr. Prince was their orthodontist and if he left the corporation and opened a practice elsewhere in the area, the patients could follow him. Dr. Prince had no covenant not to compete with his professional

corporation. Because of that fact, experts for both sides agreed that the professional corporation's value would not exceed the $7,500 value of its hard assets if Dr. Prince had no covenant to compete with the corporation.

The bankruptcy judge found that earnings from services to be performed by the individual debtor Dr. Prince after the commencement of the case were excluded from property of the estate under ll U.S.C. §541(a)(6) and categorized good will (covenant not to compete) within the category of earnings after the commencement of the case and therefore held that such good will would not be an asset available for creditors. He also held that nothing in the reorganization even hinted that Dr. Prince's good will was to be included in the value of the assets of the estate to which creditors had rights. He valued the stock at $7,500.

On appeal, the District Court reversed holding that good will in a covenant not to compete was not exempt future earnings for services, but rather was earnings for not performing services and thus was not exempt from inclusion in the estate under 11 U.S.C. §541(a)(6). It was further held that whereas the parties had not included the value of Dr. Prince's good will, that may have been excluded because of oversight as to consideration and therefore good will would be included in the value of the stock, unless it could be proved that both the creditors and debtors intended to exclude good will.

On remand there was no admission by the creditors that they intended to exclude Dr. Prince's good will from the value of the stock and the stock was valued at $405,440 which was the post-confirmation sales price

of the stock plus the covenant not to compete less expenses Dr. Prince was required by contract to expend during a transaction period.

On appeal the Seventh Circuit affirmed the inclusion of Dr. Prince's good will in the value of the stock stating that his good will was created through years of his practicing in the community and therefore was independent from his "human capital" and not within the future earnings exception to inclusion in the bankruptcy estate because it was created by debtor's past labors.

REASONS RELIED UPON FOR ALLOWING THE WRIT

THE WRIT SHOULD BE GRANTED BECAUSE THIS CASE HAS WIDE EFFECT DEALING WITH WHETHER PROFESSIONALS OR THE BANKRUPTCY ESTATE OWNS GOOD WILL OF PROFESSIONALS IN CHAPTER 11 REORGANIZATIONS AND THERE IS A SPLIT OF AUTHORITY BELOW ON THAT SUBJECT THAT REQUIRES A RESOLUTION AND FURTHER THE SEVENTH CIRCUIT IGNORES STATE SUPREME COURT LAW ON THE SUBJECT CONTRARY TO DECISIONS OF THE UNITED STATES SUPREME COURT.

There are thousands and thousands of professionals and others who can be affected by the decision below. There are attorneys, physicians, accountants, engineers, consultants, etc. who are affected by the subject of this writ. That includes the prominent such

as heart surgeon Denton Cooley, 87 B.R. 432, to all the others. As this case shows, the different interpretations as to who owns their good will can have an effect of hundreds of thousands of dollars. If a bankruptcy trustee or bankruptcy estate owns their good will because they built their reputations prior to bankruptcy, their reputations are for sale and they will be subject to huge restrictions on the future right to earn money through their professions because covenants that restrict where they practice can be imposed to transfer their good will and to nullify their reputations in the area where they practiced so a new entity can try to capitalize on the personal professional good will of the person involved.

The debtor is entitled to a fresh start as of the commencement of a chapter 7 or 11 case. In re Cooley, 87 B.R. 432, 437-8.

There is a split of authority below as to whether a covenant not to compete is the property of the debtor. Collier on Bankruptcy, King, 15th Ed., Vol. 4, Sec. 541.19. In re Johnson, 178 B.R. 216, (9th B.A.P. 1995) and In re Andrews, 153 B.R. 159, (B. Ct.,Va., 1993), cited for inclusion of the covenant as property of the estate and In re Hammond, 35 B.R. 219 (B Ct., W.D. Okla., 1983) is cited as an example of the covenant not being owned by the bankruptcy estate. Since that citation, In Re Andrews was appealed to the 4th Circuit which in a split decision, citing the case that is subject to this writ, Prince, as authority in footnote 10, held in a 2-1 decision that the covenant was part of the bankruptcy estate with a strong dissent to the contrary. In re Andrews, 80 F.3d 906 (4th Cir., 1996). In the current case, the covenant was signed after the bankruptcy and thus came into existence after

the bankruptcy, and that has been ruled to cause the value of the covenant and its preservation of good will not to be part of the bankruptcy estate. In re Schneider, 864 F.2d 683 at 685-6 (lOth Cir., 1988). These court conflicts need resolution.

The determination of property interests in bankruptcy is generally governed by state law. Butner v. United States, 440 U.S. 48 at 51-56. The Illinois Supreme Court has cited:

> "Although many businesses possess this intangible known as good will, the concept is unique in a professional business. The concept of professional good will is the sole asset of the professional. If good will is that aspect of a business which maintains the clientele, then the good will in a professional business is the skill, the expertise, and the reputation of the professional. It is these qualities which keep patients returning to a doctor and which would make those patients refer others to him. The bottom line is that this is reflected in the doctor's income generating ability". In re Marriage of Zells, 572 N.E. 2d 944-at 946, 143 Ill. 251 (1991).

Also, under Illinois law, good will cannot exist as to other than purely commercial or trade partnerships or businesses of that nature, except by special contract (like a covenant not to compete) because in a business of a professional nature, as that of an attorney or apothecary, the good will attaches to the person rather than to any other subject. Estate of McCubbin, 125 Ill. App. 3d 74 at 77-8). Further, in Illinois there are no

implied covenants not to compete. Carroon & Black of Illinois v. Mager, 494 N.E. 2d 785 (Ill. App., 1964).

Because the Seventh Circuit opinion is one on which there is a split of authority and involves a serious question affecting so many professionals, because it fails to follow the mandate of the United States Supreme Court that the determination of property interests in bankruptcy is generally governed by state law and it ignores the relevant state law, this petition for a writ of certiorari should be granted.

October 6, 1996

Respectfully submitted,

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APPENDIX

In the

United States Court of Appeals

For the Seventh Circuit

Nos. 94-3474 & 94-3714

IN THE MATTER OF: DOUGLAS R. PRINCE and JANE PRINCE,

Debtors-Appellants.

Appeal from the United States District Court
for the Northern District of Illinois,
Eastern Division.
No. 89 C 8278—John F. Grady, *Judge*,
and No. 94 C 3341—Suzanne B. Conlon, *Judge*.

ARGUED SEPTEMBER 18, 1995—DECIDED MAY 31, 1996

Before FLAUM, KANNE, and ROVNER, *Circuit Judges*.

KANNE, *Circuit Judge*. When Dr. Douglas R. Prince and his wife, Jane Prince, filed for bankruptcy reorganization in 1981, Dr. Prince operated his orthodontics practice as a wholly owned professional corporation. As part of the plan of reorganization, Dr. Prince was to retain his practice, but the Princes agreed to pay the equity value of his stock in the professional corporation into a fund to satisfy their unsecured creditors. When the Princes and the unsecured creditors committee could not agree upon the stock's worth, they turned to the bankruptcy

court for a valuation hearing. The bankruptcy court determined that the stock was worth only the value of the practice's physical assets, but on appeal the district court reversed and remanded for a calculation of the stock's value that included Dr. Prince's goodwill. On remand, the bankruptcy court's recomputation arrived at a markedly higher value for the stock. After the entry of judgment, the unsecured creditors committee filed a motion to alter or amend the judgment on the basis of newly discovered evidence. The bankruptcy court granted the motion and amended its judgment to further increase the value of the stock, and the district court affirmed this decision on appeal. The Princes now challenge both the ruling that Dr. Prince's goodwill was properly included in the value of his stock and the decision to grant the unsecured creditors committee's motion to alter or amend the judgment, and we affirm.

I. History

On August 17, 1981, Dr. Prince and his wife filed a voluntary petition for bankruptcy reorganization under Chapter 11. *See* 11 U.S.C. § 1101 *et seq.* At the time of filing, Dr. Prince was the sole shareholder of a professional corporation, through which he operated his practice as an orthodontist. In February of 1983, the Princes filed a combined disclosure statement and plan of reorganization proposing the liquidation of their estate. The plan was supported by the unsecured creditors committee (the "Committee") and was confirmed on November 4, 1983.

The plan required the Princes to marshal the equity value of all their assets into a fund for distribution to their creditors. The Princes could either sell each asset and remit the sale proceeds to the fund, or they could retain an asset by depositing into the fund, over a three-year period, an amount equal to its equity value. The plan indicated that Dr. Prince wished to retain his orthodontics practice and would therefore pay the equity value of his

stock in the professional corporation into the fund. The plan was confirmed, however, without the parties ever agreeing upon the stock's value. In the plan, the Princes disclosed that the corporation's physical assets were worth $25,000, less equipment liens totaling $17,500, and thus proposed to pay an equity value of $7,500 into the fund, subject to audit and negotiations with the Committee. In the event that postconfirmation negotiations failed to reach an accord as to the value of the stock, the plan provided that the dispute would be resolved at a valuation hearing before the bankruptcy court. The parties have yet to agree upon the stock's worth.

Less than four months after confirmation, Dr. Prince negotiated the sale of his practice to an orthodontist from New York, Dr. Timothy J. Clare. On February 25, 1984, the two doctors signed a written sales contract, wherein Dr. Clare promised to pay a purchase price of $450,000,[1] with payments to commence in September of 1984. Dr. Prince's obligation under the agreement was threefold: First, he promised to transfer all of the professional corporation's stock to Dr. Clare. Second, Dr. Prince agreed to enter into a covenant not to compete, under which he was prohibited for five years from practicing within ten miles of any community he had previously served. Third, Dr. Prince undertook a "practice obligation" to provide transitional services during the interim period—i.e., from February to September, Dr. Prince would pay some of Dr. Clare's expenses (salary, housing, gas, insurance, travel), continue to practice on a part-time basis, and use his best efforts to build a rapport between his patients and Dr. Clare. After work-

[1] More precisely, the agreement stated that Dr. Clare would pay "$450,000.00 amortized at 12% simple interest for 5 years, and $500,000.00 amortized at 10% simple interest for 5 years. The payment amount shall be $120,000 per year including principal and interest. The balance, if any, from each of these calculations at the end of the five year period shall be averaged to obtain the final payment amount for the sixth year."

ing together until only June, however, the two doctors had a falling out, and the actual sale in September was never consummated.

In November of 1988, the bankruptcy court held a hearing to determine the value of Dr. Prince's stock in his professional corporation. The Committee and the Princes each put forth an expert witness, and the bankruptcy court believed that "[b]oth experts testified in a credible fashion, consistent with their respective assumptions." The Committee's expert concluded that the stock of the professional corporation was worth $650,000, based on a capitalization of the stream of cash flows that the practice was likely to produce in the future (Dr. Prince had previously disclosed that he enjoyed an annual income from the practice of between $250,000 and $300,000). The Committee's expert conceded, however, that this value would not exist if Dr. Prince were to leave and compete with the corporation. The expert testified that without the personal goodwill of Dr. Prince—defined by the bankruptcy court as "the confidence that his patients had in him as an orthodonist"—the stock would have only nominal value.

The methodology of the Princes' expert assumed that Dr. Prince's goodwill should not be included in the stock's value because the professional corporation did not possess a covenant not to compete from Dr. Prince. As a result, and consistent with the Committee expert's concession, he determined that the corporation's stock was equal to the liquidation value of its physical assets, or $7,500. The Princes' expert admitted, however, that almost every sale of a medical or dental practice entails the execution of a covenant not to compete, the exceptions usually being where a physician has expired and thus presents no risk of competition.

On the basis of the experts' testimonies, the bankruptcy court found virtually every fact in this case to be undisputed and distilled the valuation down to one issue of law: "whether Dr. Prince's personal goodwill should be included in the calculation of [the stock's] value." The

bankruptcy court determined as an initial matter that Dr. Prince's goodwill fell within the personal earnings exception of 11 U.S.C. § 541(a)(6), which excludes the debtor's postcommencement earnings from the bankruptcy estate in a liquidation. Because the liquidation of the Princes' estate was proposed as part of a plan of bankruptcy reorganization under Chapter 11, rather than as a Chapter 7 liquidation, the bankruptcy court recognized that the parties could have bargained around § 541(a)(6)'s presumptive exclusion and particularly specified whether the value of Dr. Prince's goodwill was to be paid into the fund. However, the court found that the plan itself did not evidence the parties' intention either to include or exclude the value of Dr. Prince's goodwill, and thus it concluded that the stock's worth was limited to the $7,500 value of the professional corporation's physical assets.

On appeal, the United States District Court for the Northern District of Illinois disagreed with the bankruptcy court and held that Dr. Prince's goodwill did *not* fall within the personal earnings exception of 11 U.S.C. § 541(a)(6). As a result, the district court remanded the case, instructing the bankruptcy court to include the worth of Dr. Prince's goodwill in the stock's value. Because the bankruptcy court had determined that the stock's worth was limited to $7,500, and thus had not endeavored to assign a value to Dr. Prince's goodwill, the district court advised the bankruptcy court how it should go about calculating the value of the goodwill. Finding the arm's length sale agreement between Dr. Prince and Dr. Clare to be an accurate proxy for the worth of the stock, the district court directed the bankruptcy court to calculate the value of Dr. Prince's stock (physical assets plus goodwill) by subtracting the amount of Dr. Clare's salary and expenses paid under the contract, as well as the value of the tangible services performed by Dr. Prince during the interim period, from the purchase price to be paid by Dr. Clare.

On remand, the bankruptcy court accepted evidence and argument as to the value of the amounts that should be

offset against the purchase price in determining the worth of the stock. During final argument, it occurred to the court and the parties that a crucial issue was whether Dr. Prince or Dr. Clare received the income from the practice during the interim period. If Dr. Clare received the income, then some portion of the purchase price could be considered compensation for Dr. Prince's part-time labors during the interim period rather than for the stock, and thus the value of these labors would be properly deducted from the purchase price in determining the value of the stock. On the other hand, if Dr. Prince received the income himself, then that income would be his compensation, and the value of his interim labors would not be offset against the purchase price.

Without adjournment, the bankruptcy court recalled Dr. Prince to testify as to which doctor received the practice's income during the interim, and Dr. Prince testified that Dr. Clare had received such income. The Committee argued that this testimony was inconsistent with the fact that Dr. Clare was paid an interim salary under the sales contract, but it could offer no real evidence at that time to contradict Dr. Prince's testimony. Thus, on the basis of the evidence from this hearing, the bankruptcy court recalculated the value of Dr. Prince's stock to be $292,290, which represented the purchase price of $450,000, less (1) the amount of Dr. Clare's salary and expenses that were paid under the contract and (2) an assigned wage for Dr. Prince's part-time labor during the interim period.

The Committee promptly filed a motion to alter or amend the judgment under FED. R. CIV. P. 59(e), pointing to evidence in the record suggesting that Dr. Prince had received the income from the practice during the interim period and therefore that an assigned wage for Dr. Prince's part-time interim labor should not have been deducted. Before ruling on the motion, the bankruptcy court granted the Committee leave to obtain the practice's bank records to determine conclusively the recipient of the income. After reviewing the bank records, the bankruptcy court found it indisputable that Dr. Prince had

in fact received the practice's interim income. As a result, the bankruptcy court granted the Committee's motion and amended the judgment to value the stock at $405,440. On appeal, the United States District Court for the Northern District of Illinois affirmed the bankruptcy court's decision to grant the motion.

II. Analysis

The Princes now ask this court to resolve two issues: (1) whether the district court erred in directing the bankruptcy court to include Dr. Prince's goodwill as part of the value of his stock in the professional corporation; and (2) whether the district court erred by affirming the bankruptcy court's grant of the Committee's motion to alter or amend the judgment.

A. Valuation of Dr. Prince's Stock

The Princes proposed the liquidation of their estate as a plan of reorganization under Chapter 11, rather than as a bankruptcy liquidation under Chapter 7. As such, the bankruptcy court correctly noted that the parties could have particularly specified in the plan the dollar value for the stock that Dr. Prince would be required to pay into the creditors' fund. The parties and the lower courts agree, however, that the plan contains no indication of the parties' intent concerning whether goodwill should be included in, or excluded from, the proper valuation of the stock. Therefore, we must determine whether Dr. Prince's goodwill should, in the absence of guidance from the parties, be included as part of the value of his stock—a determination that presents a question of law, over which we exercise *de novo* review. *Pilditch v. Board of Educ. of the City of Chicago*, 3 F.3d 1113, 1115 (7th Cir. 1993), *cert. denied*, *Pilditch v. Gool*, 114 S. Ct. 1065 (1994).

We are not asked on appeal to review the district court's application of law to the facts because the factual consequences hinging upon whether Dr. Prince's goodwill is treated as part of the stock value are undisputed. Both

parties agree that if Dr. Prince's goodwill is excluded from the valuation calculus, the worth of the stock is limited to the $7,500 of physical assets. On the other hand, assuming that Dr. Prince's goodwill is properly included in the stock's value, the Princes do not assert error in the bankruptcy court's numerical computation of the goodwill's value; they appeal only the district court's grant of the Committee's motion to alter or amend the judgment on the basis of new evidence.

The Princes contend that they are required to pay no more than the $7,500 value of the practice's physical assets into the creditors' fund, and their argument in support of this contention has two components. First, they argue that from a conceptual standpoint, Dr. Prince's goodwill should not be included in the value of the professional corporation's stock. Secondly, the Princes argue (as the bankruptcy court initially decided) that even if Dr. Prince's goodwill does theoretically constitute part of the worth of the stock, the value of the goodwill must be excluded from the bankruptcy estate by virtue of the Bankruptcy Code's postcommencement earnings exception in 11 U.S.C. § 541(a)(6).

Addressing the first component of the Princes' argument requires a brief explanation of the principles of stock valuation. *See generally* RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 29-68 (4th ed. 1991). In general, stock as an asset has value because of its capacity to generate cash flows in the future.[2] Shareholders may expect to receive future cash flows from the stock in three ways: (1) as dividends when corporate profits are periodically distributed to the company's shareholders; (2) as capital appreciation (or decline) when

[2] This, of course, excepts those situations where a shareholder derives some nonpecuniary personal benefit from part ownership in a company—such as where a life employee proudly holds stock in his employer, or where a loyal fan holds stock in his favorite sports franchise.

the stock is sold at some point in the future for a profit (or loss); and/or (3) as liquidation distributions when, upon dissolution of the company, the shareholders receive the residual value of the company's assets after all creditor claims have been satisfied. In financial terms, the value of the stock on any given day (its "present value") is how much money an investor would be willing to pay on that given day in order to obtain the right to receive the stock's cash flows in the future. *See also Beerly v. Dept. of Treasury*, 768 F.2d 942, 946 (7th Cir. 1985), *cert. denied*, 475 U.S. 1010 (1986).

Theoretically, the stock's present value would be derived first by plotting out the stock's expected future cash flows, based essentially on an aggregation of the probabilities of all possible future events. This projected stream of income would then be "discounted" back to the present day (i.e., reduced to the value that someone would be willing to pay today for the expected cash flows in the future), using a discount factor that accounts for (1) the uncertainty (or riskiness) of the future cash flow projections and (2) the purchaser's opportunity cost of investing money in the stock rather than in some other available wealth-producing asset.

Unfortunately, it is often quite difficult to accurately estimate stock's future cash flows or to choose the appropriate discount factor. As a result, calculations of stock's present value will invariably be uncertain approximations. *See Metlyn Realty Corp. v. Esmark, Inc.*, 763 F.2d 826, 835-36 (7th Cir. 1985); Daniel R. Fischel, *The Appraisal Remedy in Corporate Law*, 1983 AM. B. FOUND. RES. J. 875, 890-91. The Committee expert attempted to estimate the present value of the stock by projecting the practice's past earnings into the future and then discounting these future cash flows back to the time of confirmation using what he believed to be the appropriate discount factor. Conceptually, the Committee expert had the right idea: on the date of confirmation, while Dr. Prince owned the stock, the value of the stock would indeed be the discounted value of the future cash flows that on that date

Dr. Prince's practice could have been expected to receive in the future. The Committee expert's calculation of earnings value, however, was subject to a significant range of error based on the expert's subjective choice of a discount factor, as well as on the fact that the expert's projections of future cash flows were based on some function of Prince's *past* earnings from his practice, which could have been, but were not necessarily, an accurate reflection of what his practice's earnings would be in the future. *See Metlyn Realty*, 763 F.2d at 835; Fischel, 1983 AM. B. FOUND. RES. J. at 891.

Due to these difficulties in approximation, where market information is available, looking to the stock's "fair market value"—what an arm's length buyer would be willing to pay for the stock on the open market—is generally the best means of gauging the stock's present value. This court has noted that in a properly functioning market, especially where the stock is frequently traded among a number of different buyers and sellers, the price that buyers are presently willing to pay—and that sellers are willing to accept—for shares of the stock is usually the most accurate representation of the present value of the stock's future cash flows. *Beerly*, 768 F.2d at 946; *Metlyn*, 763 F.2d at 835. The collective appraisal of market participants is considered to be a more reliable measure of the stock's value than the subjective estimates of one or two expert witnesses. *Metlyn*, 763 F.2d at 835; Fischel, 1983 AM. B. FOUND. RES. J. at 891 & n.68.

As a result, the district court instructed the bankruptcy court to look to the purchase price agreed upon by Dr. Prince and Dr. Clare as an estimate of the stock's present value on the date of confirmation. Now it is true that, as in this case, where stock is traded infrequently (or only once), recent sales may not be as reliable an indicator of current value as the equilibrium market price for a stock that is heavily traded "because they impound valuations by only a few buyers and sellers, and because circumstances may have changed since those sales took place." *Beerly*, 768 F.2d at 946. However, here Dr. Clare and

Dr. Prince negotiated the stock's sale price at arm's length; as orthodontists they both had considerable information concerning the probable worth of the practice; and the signing of the sale agreement occurred almost concurrently with the confirmation of the plan. As a result, the agreed-upon purchase price is likely to represent a reasonably accurate estimation of the present value of Dr. Prince's stock on the date of confirmation.

The Princes argue that when measuring the present value of the practice, the worth of the stock should be limited to the $7,500 liquidation value of the practice's physical assets. In most cases, liquidation value is only an appropriate estimation of stock worth where a company is dissolving. *Shanno v. Magee Indus. Enter., Inc.*, 856 F.2d 562, 566 (3d Cir. 1988). In dissolution, liquidation distributions are the only foreseeable future cash flows to the shareholder, and thus liquidation value is an accurate tool for measuring the stock's present value. On the other hand, where a business is expected to continue as a going concern, the company's expected future earnings from operations often far exceed the liquidation value of the company's physical assets. Thus, when valuing a business that is continuing to operate as a going concern, liquidation value is generally an inaccurate approximation of what shares are worth to the shareholders. *See Beerly*, 768 F.2d at 946; *see also In re Winthrop Old Farm Nurseries*, 50 F.3d 72, 74 & n.2 (1st Cir. 1996) (collecting cases).

Nonetheless, the Princes maintain that the stock's worth on the date of confirmation was no more than the $7,500 value of the practice's physical assets because the corporation did not possess a covenant not to compete from Dr. Prince. They reason that because (as the Committee expert conceded) the stock would be worth only $7,500 if Dr. Prince were to leave the corporation and compete with it, and because the corporation did not have a contractual guarantee that Dr. Prince would not leave and compete, the stock value should be limited to $7,500.

This argument, however, misunderstands the concept of present valuation. The bankruptcy court's task was not

to determine the present value of the stock as of some hypothetical future day when Dr. Prince left to compete with his own corporation, but to determine the value of the stock on the day the bankruptcy reorganization plan was confirmed. Present value is derived by discounting back a projected stream of future cash flows, and this stream of cash flow projections is based on the probability of possible future events. On the day the plan was confirmed, Dr. Prince's leaving and competing with the corporation was hardly a 100 percent certainty. It was a possible event that affected the value of the stock: the higher the probability of him competing, the lower the expected future cash flows to the stock, and the lower the probability of him competing, the higher the expected future cash flows to the stock. But the mere possibility that he might leave to compete with the corporation does not render the stock worthless any more than the possibility of fire destroying an uninsured house strips that house of every cent of its present value. What is important for calculating present value is the *probability* of a particular future event occurring.

Granted, if Dr. Prince's professional corporation had for some reason possessed a covenant not to compete from Dr. Prince, it would have ensured that the probability of his leaving to compete with the practice would be zero.[3] However, it is not clear that the probability of him leaving and competing was any higher than zero despite the absence of a covenant not to compete. At the time the plan was confirmed, Dr. Prince was operating the practice, and it seems quite unlikely that while still owning the stock he would have abandoned his practice, moved across the street, and competed with himself. When Dr. Prince

[3] Of course, the existence of an enforceable covenant not to compete would not absolutely ensure that Dr. Prince would not compete with the corporation. It would, however, make Dr. Prince liable for any loss in revenue to the corporation from his competition, and thus would ensure that there would be no reduction in cash flows to the stock as a result of any competition from Dr. Prince.

agreed to sell the practice to Dr. Clare, a covenant not to compete became necessary because there would exist a significant probability that Dr. Prince might compete with Dr. Clare and thereby reclaim any goodwill transferred as part of the sale. But at the time of confirmation, when Dr. Prince owned the stock himself, there was no need for a covenant not to compete in order to protect Dr. Prince's substantial goodwill, which constituted the lion's share of the stock's value.

The considerable value of the practice to Dr. Prince on the date of confirmation is illustrated by the amount of money that four months later Dr. Clare agreed to pay under the sale agreement. The Princes attempt to reconcile this with their contention that the stock was worth only $7,500 when Dr. Prince owned it by pointing to Dr. Prince's promises under the purchase agreement that he would use his best efforts to build a rapport between his patients and Dr. Clare, and that he would enter into a covenant not to compete. They argue that the covenant not to compete and Dr. Prince's best efforts were newly created value, paid for by Dr. Clare, which did not exist at the time of confirmation when Dr. Prince owned the practice.

This argument, however, misunderstands how the covenant and Dr. Prince's efforts were valuable primarily as a means to effectively transfer the value of Dr. Prince's goodwill to Dr. Clare. At the time of confirmation, Dr. Prince's goodwill (his relationship of trust and loyalty with his patients) resulted in a significant amount of business, and thus earnings, for his practice. Under the sale agreement, Dr. Prince's best efforts at encouraging his patient base to continue seeing Dr. Clare were intended to substitute Dr. Clare for himself in the relationships of goodwill he enjoyed with his patients. In other words, they were to transfer Dr. Prince's goodwill to Dr. Clare. Given that after this transfer Dr. Prince could theoretically open up shop across the street, reclaim his patients, and (as the Committee expert noted) thereby leave Dr. Clare with only nominal value in the stock, the covenant not to compete was intended to ensure that Dr. Prince's transfer

of his goodwill to Dr. Clare would not be illusory. Thus, the covenant not to compete and Dr. Prince's best efforts did not represent the transfer of additional value to Dr. Clare over and above the value of the stock to Dr. Prince. Rather, they were used (as they are in virtually every sale of a medical or dental practice) merely to ensure that after the sale the practice would be as valuable in Dr. Clare's hands as it had been in Dr. Prince's.

Now this is not to mean that the covenant not to compete had no value to Dr. Clare. Rather, it means that without it, Dr. Prince's goodwill would not have been as valuable to Dr. Clare as it had been to Dr. Prince because the probability that Dr. Prince would turn around and compete with Dr. Clare was much greater than the probability that Dr. Prince would compete with himself. The purpose of the covenant not to compete was to ensure that the transfer of the goodwill together with the covenant would be worth roughly the same amount to Dr. Clare as the goodwill itself had been worth to Dr. Prince. The purchase price was therefore an appropriate measure for the bankruptcy court to rely upon when determining the value of the stock in Dr. Prince's hands on the date of confirmation.

Thus, from a conceptual standpoint, the present value of Dr. Prince's stock cannot be limited to the $7,500 value of the practice's physical assets. Instead, the bankruptcy court was entirely justified in looking to the Committee expert's calculations or the agreed-upon purchase price between Dr. Prince and Dr. Clare as evidence of the stock's present value. However, given that the need for this valuation arises in bankruptcy, a calculation of the stock's present value is not the end of our inquiry. Although the Bankruptcy Code casts a broad net over the assets of the debtor, pulling virtually all the debtor's property interests into the bankruptcy estate, the Code expressly excludes "earnings from services performed by an individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6). This exclusion applies to Chapter 11 bankruptcies, *see In re FitzSimmons*, 725 F.2d 1208,

1211 (9th Cir. 1984); therefore, to the extent that any portion of the stock's present value represents postcommencement earnings from Dr. Prince's services, it is not part of the bankruptcy estate and must be excluded from the amount that Dr. Prince is required to pay into the fund.

The present value of stock in a company can be separated into what portion of the stock's value is attributable to which of the company's assets. Some of the value of stock may flow from the company's physical assets, such as equipment. Some of the company's future cash flows may be attributable to the company's human capital—its employees' skills and labor. And some of a stock's value may derive from the company's intangible assets, such as a trademark or general "goodwill." Goodwill is an intangible asset that represents the ability of a company to generate earnings over and above the operating value of the company's other tangible and intangible assets. It often includes the company's name recognition, consumer brand loyalty, or special relationships with suppliers or customers.

A good portion of the present value of the professional corporation's stock on the date of confirmation stems from the human capital of its sole employee on that date, Dr. Prince. Dr. Prince's services are valuable because of his various personal attributes, including his natural skills, his personality and demeanor, his extensive training and professional knowledge, and his license to practice dental medicine. By expending his labor in providing these services, Dr. Prince generated earnings for the practice, which resulted in profits flowing to the professional corporation's shares of stock. That portion of the stock's worth on the date of confirmation representing the value of Dr. Prince's future skilled labor is undisputedly excluded from the estate by virtue of the § 541(a)(6) postcommencement earnings exception.

However, not all of the stock's present value is attributable to Dr. Prince's future skilled labor, a fact evidenced by the sale agreement between Dr. Prince and Dr. Clare. The sale agreement price represents the value of the

practice *over and above* the value of Dr. Prince's labors.[4] To explain, after the consummation date of the sale, Dr. Prince was not expected to continue working for the practice; rather, Dr. Clare intended to substitute *his own* future skilled labor for that of Dr. Prince. Thus, after subtracting the amount of Dr. Clare's expenses and salary paid during the interim period by Dr. Prince, the purchase price represents the present value of the practice, excluding the worth of Dr. Prince's future labors—i.e., the present value of the corporation's physical assets and Dr. Prince's goodwill.

The Princes contend, as the second component of their argument, that they should only have to pay into the creditors' fund the $7,500 of the purchase price that represents the value of the corporation's physical assets. They argue that Dr. Prince's goodwill is, like his skills, training, and dental license, a personal attribute—that his goodwill is merely part of his human capital and therefore must be excluded from the bankruptcy estate under the § 541(a)(6) earnings exception. In an important sense, however, Dr. Prince's goodwill is unlike his skills, his schooling, or his dental license. These components of Dr. Prince's human capital can only manifest their value by increasing the worth of his future labors. Dr. Prince's innate physical ability, his personality, or his professional degree increase the market value of his services, but they cannot be sold to another orthodontist; they have value only as attributes of Dr. Prince. On the other hand, Dr. Prince's goodwill, like the practice's physical equipment, can be sold and transferred, and once sold and transferred can generate value for another orthodontist. Although the mechanism of using his best efforts to transfer his patients' loyalties to Dr. Clare and then securing the transfer with a covenant not to compete is not as simple as

[4] This, together with the significant margin of error inherent in earnings value calculations, likely accounts for the discrepancy between the Committee expert's estimates and the agreed-upon purchase price.

signing over title to a physical asset, the functional effect is the same. Dr. Prince could sell and deliver his goodwill to Dr. Clare, and Dr. Clare would then reap the value of the asset. Thus, Dr. Prince's goodwill is not intrinsically part of his human capital, but rather is a separate intangible capital asset of the practice, like a trademark would be.[5]

The courts have interpreted the postcommencement earnings exception extremely narrowly, holding that § 541(a)(6) excepts only earnings from services actually performed by an individual debtor after the date of commencement and that cash flows representing return on capital assets (even intangible ones) are not earnings from services of the debtor. *See In re FitzSimmons*, 725 F.2d at 1211. *In re FitzSimmons* involved an individual attorney operating his practice as a sole proprietorship, a situation quite analogous to Dr. Prince and his wholly owned professional corporation. The attorney, FitzSimmons, objected to being directed to pay any of his practice's future profits to his creditors as part of a Chapter 11 reorganization, arguing that the profits were excluded from the bankruptcy estate by § 541(a)(6). The Ninth Circuit held:

> FitzSimmons is thus entitled to monies generated by his law practice only to the extent that they are attributable to personal services that he himself performs. To the extent that the law practice's earnings are attributable not to FitzSimmons' personal services but to the business' invested capital, accounts

[5] Note that the mere fact that Dr. Prince's goodwill was created through years of his practicing in the community does not alter the conclusion that it is an asset separate from his human capital. If Dr. Prince were to have fashioned one of the practice's physical assets with his own hands, this would not change the fact that the asset could be sold and, therefore, that the asset had value independent of Dr. Prince. The earnings exception does not exclude earnings from an asset created by a debtor's past labors, only the earnings from actual services performed by the debtor in the *future*.

> receivable, *good will*, employment contracts with the firm's staff, *client relationships*, fee agreements, or the like, the earnings of the law practice accrue to the estate.

Id. (emphasis added). The same is true of Dr. Prince's stock in his professional corporation. The value of earnings from future services performed by Dr. Prince are excluded from the bankruptcy estate. As discussed above, this exclusion was accomplished by the bankruptcy court's looking to the agreed-upon purchase price as evidence of the stock's value. The purchase price (less Dr. Clare's interim salary and expenses) includes the value of the practice's physical assets (undisputedly part of the bankruptcy estate) and Dr. Prince's goodwill. The value of Dr. Prince's goodwill represents future cash flows not from earnings for future services actually performed by Dr. Prince, but from return on an intangible capital asset that could be sold and transferred with the sale of the practice. The value of Dr. Prince's goodwill is therefore not excluded from the estate by virtue of § 541(a)(6), and according to the plan of reorganization it must be paid by the Princes into the creditors fund.

B. Motion to Alter or Amend the Judgment

A court may grant a Rule 59(e) motion to alter or amend the judgment if the movant presents newly discovered evidence that was not available at the time of trial or if the movant points to evidence in the record that clearly establishes a manifest error of law or fact. *Russell v. Delco Remy Div. of General Motors Corp.*, 51 F.3d 746, 749 (7th Cir. 1995); *LB Credit Corp. v. Resolution Trust Corp.*, 49 F.3d 1263, 1267 (7th Cir. 1995) (quoting *FDIC v. Meyer*, 781 F.2d 1260, 1268 (7th Cir. 1986)). The decision whether to grant or deny a Rule 59(e) motion is entrusted to the sound judgment of the district court, and we will reverse only for an abuse of discretion. *LB Credit Corp.*, 49 F.3d at 1267.

In its motion to alter or amend the judgment, the Committee pointed to evidence in the record contradicting Dr.

Prince's testimony that Dr. Clare had received the income from the practice during the interim period. This evidence in the record, however, did not clearly demonstrate a manifest error of fact; it merely suggested that Dr. Prince's testimony might have been incorrect. Instead, the bankruptcy court's decision to amend the judgment was based on the conclusive proof of the practice's bank records, which were *not* offered into evidence prior to the entry of judgment. Because the bank records were "newly discovered" evidence, rather than evidence existing in the record, the bankruptcy court was authorized to amend the judgment on the basis of the records only if the evidence was unavailable to the Committee at the time of the hearing. *See Figgie Int'l Inc. v. Miller*, 966 F.2d 1178, 1180 (7th Cir. 1992).

The Princes argue that the district court abused its discretion by granting the Committee's Rule 59(e) motion because the bank records were in existence and accessible by the public—and therefore technically available—prior to the entry of judgment. But this argument reflects a far too simplistic interpretation of availability. This court has held that "[a] Rule 59(e) motion cannot be used to present evidence that *could and should* have been presented prior to the entry of final judgment." *Retired Chicago Police Ass'n v. City of Chicago*, 76 F.3d 856, 867 (7th Cir. 1996) (emphasis added). Where a party is made aware that a particular issue will be relevant to its case but fails to produce readily available evidence pertaining to that issue, the party may not introduce the evidence to support a Rule 59(e) motion. *Green v. Whiteco Indus., Inc.*, 17 F.3d 199, 202 n.5 (7th Cir. 1994). However, it appears that in this case the parties did not have sufficient indication prior to the hearing that the recipient of the interim income would be a relevant issue, and even once the relevance of the issue was discovered the parties were not given an opportunity to collect evidence bearing on the question. On remand to redetermine the value of Dr. Prince's stock including goodwill, the district court had instructed the bankruptcy court to consider "the purchase price paid by Clare, less the value of the tangible assets

and *the value of the transitional services rendered by Prince* in connection with the sale." (emphasis added). In light of this directive, both parties (as well as the bankruptcy court) assumed at the hearing that an amount would be deducted for Dr. Prince's part-time labors during the interim period, and they focused on quibbling over how much. Only during final argument, after all the evidence had been introduced, did it occur to the bankruptcy court and the parties that whether Dr. Prince received the practice's interim income was a crucial question.

Like the Committee and the bankruptcy judge, the Princes did not anticipate that the recipient of the interim income would be in issue and thus did not access the practice's bank records. In fact, when called to the stand, Dr. Prince testified that Dr. Clare had received the practice's income—testimony that directly contradicted the bank records' conclusive evidence. As a result, the Princes cannot maintain that the Committee was at fault for similarly failing to foresee the relevance of the bank records and therefore neglecting to produce them.

Given that the Committee had no reason to have obtained the bank records prior to the hearing, and that the bankruptcy court did not grant a continuance in order for the parties to gather evidence on the question once its relevance became apparent, we find that the bank records were effectively unavailable to the Committee prior to the entry of judgment. The bankruptcy court, therefore, did not abuse its discretion in granting the Committee's timely motion to amend the judgment on the basis of the bank records. As the district court summarized, the bankruptcy court here was faced with a choice: "It could reopen the proofs and reach a correct result or it could knowingly enter an erroneous judgment giving Dr. Prince a $105,000 windfall as a result of his own false testimony." We cannot find error in the bankruptcy court's choosing the former.

Both decisions of the district court are hereby

AFFIRMED.

A true Copy:
Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

USCA AO7XXXC-92-001—Midwest Law Printing Co., Inc., Chicago—5-31-96

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604

July 9, 1996

Hon. JOEL M. FLAUM, *Circuit Judge*
Hon. MICHAEL S. KANNE, *Circuit Judge*
Hon. ILANA DIAMOND ROVNER, *Circuit Judge*

IN THE MATTER OF: DOUGLAS R. PRINCE and JANE PRINCE, *Debtors-Appellants*.	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division
Nos. 94-3474 & 94-3714	No. 89 C 8278 John F. Grady, *Judge* and No. 94 C 3341 Suzanne B. Conlon, *Judge*.

ORDER

On consideration of the petition for rehearing with suggestion for rehearing *en banc* filed in the above-entitled cause, no judge in active service has requested a vote and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

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UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re	)	Chapter 11
	)	E O D NOV 2 21993
DOUGLAS R PRINCE	)	
and JANE PRINCE,	)	Case No. 81 B 09964
	)	
Debtors.	)	Hon. Eugene R Wedoff

ORDER

This matter was heard on the remand from the United States District Court, the Honorable John Grady, for a determination of the value of Dr. Prince's professional practice, the court having considered the evidence submitted by the parties and being otherwise advised in the premises and for the reasons stated on the record in open court on October 21, 1993, finds, and it is hereby ordered that the value Dr. Prince's professional practice, including goodwill, as reflected by the purchase and sale agreement between Dr. Prince and Dr. Clare, was $450,000, from which the following deductions are to be made:

1. $112,500 for the value of Dr. Prince's services, to be rendered after execution of the agreement;

2. $7,200 for housing provided to Dr. Clare;

3. $360 for gasoline provided for Dr. Clare;

4. $7,000 for travel expenses allowed to Dr. Clare;

5. $650 for payment of professional liability insurance for Dr. Clare; and

6. $30,000 of salary paid to Dr. Clare.

Accordingly, the court determines that the net value of the practice, including goodwill, to be $292,290.

BY THE COURT:

Dated: 11-18-93 _____

Daniel A. Zazove
Norman P. Jeddeloh
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20 N. Clark St., #1000
Chicago, IL 60602
312/641-1155

89-08278.411

April 10, 1991

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

IN RE: DOUGLAS R. & JANE PRINCE	)	81 B 9964
UNSECURED CREDITORS COMMITTEE,	)	
Plaintiff,	)	
v.	)	No. 89 C 8278
DOUGLAS R. PRINCE and JANE PRINCE,	)	
Defendants.	)	

MEMORANDUM OPINION

This is an appeal pursuant to 28 U.S.C. § 158 from the United States Bankruptcy Court for the Northern District of Illinois (No. 81 B 9964). The decision of the bankruptcy court is reversed, and the case is remanded for further proceedings.

FACTS

Dr. Douglas R. Prince ("Prince"), an orthodontist, and his wife Jane (collectively "the debtors") filed a joint Chapter 11 petition on August 17, 1981. At the time of filing, Prince was the sole shareholder in a professional corporation, Douglas R. Prince, D.D.S., M.S., Ltd., which rendered professional services

exclusively through Dr. Prince. On November 4, 1983, the bankruptcy court confirmed the debtors' Amended Disclosure Statement and Plan ("plan"), which provided that Prince would retain the professional corporation's stock and continue to operate his orthodontic practice. In consideration for retaining the stock, Dr. Prince agreed to pay its value to his bankruptcy estate.

In his initial disclosure statement and plan, Prince had proposed to pay his estate $7,500.00 for the stock, an amount equal to the value of the professional corporation's physical assets less the encumbrances on those assets. The Unsecured Creditors' Committee ("Committee") objected to this proposed valuation and entered into negotiations with Prince to modify the plan as to the stock value. The parties were unable to agree on the value and reserved the issue until after confirmation of the plan. The plan provided that, if the parties could not agree on the value of the stock, the bankruptcy court would hold a valuation hearing.

Shortly after confirmation of the plan, Prince negotiated a sale of his practice to another orthodontist, Dr. Timothy J. Clare ("Clare"). On February 25, 1984, Prince and Clare entered into a contract for the sale of all the stock and assets of the professional corporation for a purchase price of $450,000.00 or $500,000.00, depending on the interest rate used. This amount was consistent with the value that Prince had declared in a personal financial statement dated March 1, 1980, sixteen months before the bankruptcy. The sale contract imposed two conditions on Prince beyond the transfer of the stock and assets of the professional corporation. First, the contract (¶ Sixth) prohibited Prince from engaging in an orthodontic practice "in competition with the business hereby sold" for five years within ten miles of Naperville, Yorkville or Morris, Illinois, the

communities in which he had conducted the practice. Prince was also required to assist Clare in the transition:

> Fifteenth: Practice Obligation - Seller agrees to practice two weeks each month as scheduled during the months of March, April, and May. During the months of June, July, and August Seller shall work in the offices one week per month as scheduled. Seller shall follow the direction of the Buyer in regards to scheduling time with patients, dentists, and a marketing program and shall put forth his best efforts and energies and ideas to promote and develope [sic] the practice in an acceptable manner to Buyer.

The Creditors' Committee and the debtors never did agree on the value of the stock. The debtors insisted that the value was $7,500.00, while the Committee argued that the value was $650,000.00. Judge Wedoff therefore conducted a valuation hearing. At the hearing, the Committee and the debtors each relied principally on their own expert witnesses. Judge Wedoff found that both experts "testified in a credible fashion, consistent with their respective assumptions." The Committee's expert testified that the professional corporation stock was worth $650,000.00, based on capitalization of the stream of income that the practice was likely to produce in the future. According to the bankruptcy court, the Committee's expert "conceded that this value would not exist if Dr. Prince were free to compete with the [professional corporation], and acknowledged that, without the personal goodwill of Dr. Prince, there would be only a nominal value in the corporate stock." In re Prince, No. 81 B 9964, Memorandum of Decision at 4 (Sept. 15, 1989)

(Wedoff, J.). The debtors' expert opined that the professional corporation's stock had "only nominal value, based on a liquidation analysis that concededly excluded Dr. Prince's personal goodwill." Id.

The Bankruptcy Court's Analysis

Judge Wedoff began his analysis by analogizing the amended bankruptcy plan to a contract. His objective was to determine "whether the parties intended to include Dr. Prince's personal goodwill in the value of the stock by analyzing the relevant Plan provisions as they relate to the Plan as a whole." Id. at 5. The court defined Prince's personal goodwill as "the confidence that his patients had in him as an orthodontist." Id. at 3.

The court heard no evidence concerning the intentions of the parties at the time the amended plan was agreed to, but confined itself to an analysis of the terms of the plan itself. Three parts of the plan were found to be relevant to the question of whether the personal goodwill of the debtor was intended to be included. First, the plan contemplated liquidation of the debtors' assets. Under § 541(a)(1) and (6) of the Bankruptcy Code, the estate of the debtor is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case ...," including "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case." Interpreting this provision, Judge Wedoff held that "[u]nder the personal earnings exception, personal goodwill does not enter the debtor's estate and, thus, is not liquidated." He cited In re Fitzsimmons, 725 F.2d 1208, 1211 (9th Cir. 1984), and In re Cooley, 87 B.R. 432 (Bankr. S.D. Tex. 1988), in support of this

conclusion. Memorandum of Decision at 6.

The second significant aspect of the plan was that, in setting forth "pertinent information concerning their assets," the debtors did not refer to Dr. Prince's personal goodwill. Moreover, in the portion of the plan which describes the professional corporation, there is a reference to the fact that "[d]ebtor has listed the value of the stock of the professional corporation at $25,000 in the schedules." Plan at 19. The court believed these were strong indications "that the Plan does not consider Dr. Prince's personal goodwill an asset to be liquidated." Memorandum of Decision at 6.

The third significant feature of the plan, and the one the court regarded as most important, was that the method specified for valuing the stock "disregards Dr. Prince's personal goodwill." Memorandum of Decision at 6. This section of the plan (pp. 46-47) consists of one paragraph, which Judge Wedoff read as setting forth the valuation method consisting of "three interrelated parts." He concluded that none of the three parts contemplated a valuation of personal goodwill.

DISCUSSION

Standard of Review

We must accept the bankruptcy court's findings of fact unless they are clearly erroneous; however, we review its conclusions of law de novo. In re Excalibur Auto Corp., 859 F.2d 454, 457 n.3 (7th Cir. 1988). The bankruptcy court's interpretation of the plan, based solely on the plan without resort to extrinsic evidence, constitutes a legal finding which this court can review de novo. See International Ass'n of Machinists v. General Electric Corp., 865 F.2d 902, 905 (7th Cir. 1989) (applying, although questioning

the continued appropriateness of, the general principle of plenary appellate review of contractual interpretations). Further, the bankruptcy court's determination that, under 11 U.S.C. § 541(a)(6), Dr. Prince's personal goodwill does not enter the debtors' estate and, therefore, is not liquidated is a ruling on a question of law.

The Earnings Exception

Judge Wedoff held that Dr. Prince's personal goodwill -- "the confidence that his patients had in him as an orthodontist" -- was exempted from his bankruptcy estate by virtue of the § 541(a)(6) exclusion for "earnings from services performed by an individual debtor after the commencement of the case." Neither Judge Wedoff's opinion nor the brief of Dr. Prince in this court explains the relationship between goodwill and post-petition earnings. Judge Wedoff relied on two cases in concluding that § 541(a)(6) exempted Prince's goodwill. In re Fitzsimmons, 725 F.2d 1208 (9th Cir. 1984), was a Chapter 11 proceeding involving a debtor who practiced law as a sole proprietorship but employed other attorneys and various staff members. The bankruptcy trustee argued that § 541(a)(6) did not apply to any post-petition earnings of the business, even those generated by the services of the debtor-in-possession himself. The debtor, on the other hand, contended that § 541(a)(6) exempted all of the post-petition earnings of the practice from the bankruptcy estate. The court held that § 541(a)(6) did apply, but that it exempted:

> only those earnings generated by services personally performed by the individual debtor. Fitzsimmons is thus entitled to monies generated by his law practice only to the extent

> that they are attributable to personal services that he himself performs. To the extent that the law practice's earnings are attributable not to Fitzsimmons' personal services but to the business' invested capital, accounts receivable, good will, employment contracts with the firm's staff, client relationships, fee agreements, or the like, the earnings of the law practice accrue to the estate.

725 F.2d at 1211 (emphasis added).

The case of In re Cooley, the other authority cited by Judge Wedoff, involved the question of whether a physician's bankruptcy estate was entitled to the physician's post-petition earnings that were attributable to the goodwill of his practice. The bankruptcy court held that the creditors had failed to demonstrate that the goodwill was "business goodwill" rather than "personal goodwill," 87 B.R. at 442, and that

> his personal goodwill is inextricably bound up with his personal services and is not by operation of the earnings exception property of the estate. Dr. Cooley's personal goodwill is of the same nature as his medical degree and license to practice medicine which although arguably property under state law, are nonetheless inextricably bound up with his postpetition services. See Ryan v. Lynn (In re Lynn), 18 B.R. 501 (Bankr. D.Conn. 1982) (In light of the earnings exception, debtor's medical degree and license are not property of the estate for purposes of bankruptcy law).

87 B.R. at 443.

Fitzsimmons and Cooley are relevant to the case at hand, but they do not support an earnings exception for Prince's personal goodwill. Both cases involved efforts of the trustee to capture what the courts concluded were clearly earnings from the debtors' post-petition services. Judge Wedoff apparently believed that the contract between Prince and Clare called for payments to Prince for his post-petition services. This was true, but only to a very limited extent. Prince was to practice two weeks during each of the months of March, April and May 1984. Then he was to work in the offices one week per month during June, July and August. This latter work would include using his best efforts to promote and market the practice in a manner acceptable to Clare. Thus, the contract did call for some post-petition services by Prince. Some portion of the purchase price for the practice may be attributable to those services, but it could not reasonably be thought that the entire purchase price for the practice, $450,000.00 or more, was in payment for those nine weeks of service.

The other thing required of Prince by the contract was that he refrain from competing with Clare for five years within ten miles of the three locations of the practice. The bankruptcy court did not discuss the covenant not to compete except to observe that the covenant, along with the requirement that Prince use his best efforts to promote the practice, "had the effect of attempting to transfer Dr. Prince's personal goodwill -- the confidence that his patients had in him as an orthodontist -- to Dr. Clare." Memorandum of Decision at 3. Prince himself believed that his covenant not to compete was what gave the stock practically all of its value. In a letter he wrote to Dr. Clare dated February 27, 1984, he stated:

> The fact that I will covenant not to compete will then allow the patients to stay with you. The value of the assets and liabilities as we agreed is the $25,000.00 and what the value of the covenant not to compete is, is the $425,000.00 or $475,000.00 at 12% and 10% respectively calculated as per the contract. As we agreed if I sold you the corporation and then I stayed in the area and practiced most if not all the patients would want and choose to remain in my care. You would have the furniture and fixtures and accounts to work already done but not the patients as the patients are free to choose who they want to treat them and would stay with me.

Committee Exh. 15, p. 3. At the conclusion of the letter (pp. 6-7), Prince stated that his explanations were intended to clarify the contract and, unless he heard from Clare to the contrary within two weeks, the letter would be considered part of the contract. The record does not indicate that there was any response from Clare, and there does not appear to be any reason why he would have disagreed with these comments in the letter or have objected to their becoming part of the contract.

The bankruptcy court, in analyzing the amended bankruptcy plan as a contract, attempted to arrive at the intention of Prince and the Creditors' Committee, the parties to the plan. In determining that intent, the nature of the contract between Prince and Clare is relevant. Clearly, Prince understood that the value of his stock resided primarily in the personal goodwill of his practice, which he was transferring by means of his covenant not to compete. This use of a covenant not to compete as the means of transferring the goodwill of a business is well recognized in the law. See, e.g.,

O'Sullivan v. Conrad, 44 Ill. App.3d 752, 358 N.E.2d 926, 929 (5th Dist. 1976), where the court upheld a restrictive covenant against the contention that it was unreasonably broad:

> The interest which the purchaser is entitled to protect by a restraint is the enjoyment and possession of the good will of the property transferred to him.

The exact relationship between the covenant and the goodwill was described as follows:

> In exchange for the restriction, the plaintiff is paying the defendant $73,000.00 for good will.

Id at 930. See also Hamer Holding Group. Inc. v. Elmore, 202 Ill. App.3d 994, 560 N.E.2d 907, 916 (1st Dist. 1990):

> [A] covenant ancillary to the sale of a business ensures the buyer that the former owner will not walk away from the sale with the company's customers and goodwill, leaving the buyer with an acquisition that turns out to be only chimerical. (citations omitted) "[I]n the sale of a business the interest to be protected is the value of the goodwill that is purchased..." (citations omitted)

See also Hirsh, "The Sale of a Medical Practice," 2 DePaul Bus. Law Journ. 183, 187 (1989) ("The monetary value of the goodwill of a physician's practice depends upon the extent to which his patient base may be transferred to the buyer.") In Russell v. Jim Russell's Supply. Inc., 299 Ill. App.3d 855, 558 N.E.2d 115, 121 (5th Dist. 1990), the court noted the

general rule "that if a business is sold and transferred from one person to another, goodwill, though not specifically mentioned, is transferred as an incident to the business." This point is relevant to the concern of the bankruptcy court that, although the professional corporation stock was mentioned in the plan, there was no separate reference to the goodwill of the practice.

The foregoing authorities cast light on whether the proceeds from Dr. Prince's sale of the professional corporation are "earnings from services performed by [him] after the commencement of the case," and are thus excepted from his estate by virtue of § 541(a)(1)(6). It is difficult to see how this statutory language can be read to describe a sale of corporate stock with a covenant not to compete. The stock itself is not "services," nor are the proceeds from the sale of the stock "earnings from services." The only post petition services involved in the Prince-Clare transaction were the transitional services to be performed by Dr. Prince from March through August 1984. As noted above, it may be reasonable to attribute some portion of the purchase price to those services, but the major consideration for the purchase price was Prince's agreement not to compete with Clare and undermine the value of the goodwill he was selling. This covenant did not contemplate "services," nor can any portion of the purchase price allocable to the covenant be considered "earnings from services." Prince was not agreeing to perform services; he was agreeing not to perform services for a period of time in certain geographical areas. In both Fitzsimmons and Cooley, the creditors were attempting to capture income generated by post-petition services actually rendered. Here, with the exception of the nine weeks of transitional assistance, no post-petition services were involved. The distinction between performing services and not performing services was recognized in

the case of In re Weyland, 63 B.R. 854, 863 (Bankr. E.D. Wis. 1986), where the court stated that it

> does not read "earnings from services performed by an individual debtor after the commencement of the case" to include payments for services not performed by the debtor.

(emphasis in original). See also In re Chastek, 1988 W.L. 105804 (Bankr. D. Minn.).

This court concludes that the earnings exception of § 541(a)(6) of the bankruptcy code does not apply to the debtor's sale of stock in his personal corporation. None of the components of the transaction -- the stock, the personal goodwill and the covenant not to compete -- are "services" within the meaning of the statute.

Neither does the rationale of the earnings exception apply to Prince's situation. The "fresh start" contemplated by the exception will not be denied Prince by a disallowance of his attempt to pocket the proceeds of the sale of his business. The restrictive covenant inhibits him from practicing his profession only in very small areas of the State of Illinois. With that exception, he can work as an orthodontist anywhere he likes, and all of his earnings will be free from the claims of his pre-petition creditors.

Discussion of Other Grounds for Excluding Debtor's Personal Goodwill From His Estate

The bankruptcy court attached importance to the reference in the plan to the fact that "[d]ebtor has listed the value of stock in the professional corporation at $25,000 in the schedules." Plan at 19. But this brief recitation in the plan does not imply that the Creditors'

Committee acquiesced in the $25,000.00 valuation. Had the Committee agreed that the stock was worth $25,000.00, it would have been simple enough to provide in the plan that this was in fact its value. Instead, the plan provided:

> In the event that debtor and the creditors' committee are not able to agree on the value of the professional corporation, it will be necessary to conduct a valuation hearing to determine the present value of the professional corporation.

Plan at 47.

The bankruptcy court was strongly influenced by the absence of any mention of the debtor's personal goodwill in the plan. If Judge Wedoff thought the failure of the plan to mention goodwill meant that the parties intended to exclude it as an element of value, it is not clear why he thought that. While it is true that there is no specific inclusion of goodwill, neither is there anything in the plan that specifically excludes it. The failure to exclude should have some significance, or at least warrant some discussion, unless it is assumed that the creditors had a unilateral burden to list every constituent element of the "present value of the professional corporation." Such an assumption, whatever else might be said of it, would seem anomalous in view of the broad definition of "property of the estate" found in § 541 of the code.

The bankruptcy court's analysis of "the Plan's method for valuing the stock" led it to conclude that Prince's personal goodwill was disregarded. It is certainly true that this language of the plan (B. Professional Corporation, pp. 46-47) contains no suggestion that the parties were specifically thinking

about Dr. Prince's personal goodwill. More broadly, however, there is no indication in this or any other portion of the plan that the parties were contemplating a sale of the business to a third person. There is no indication that the Creditors' Committee knew Prince intended to sell, and the record is silent as to when Prince formed that intention. The paragraph of the plan dealing with the professional corporation -- the section the bankruptcy court regarded as providing for a method of valuation of the stock -- begins by reciting that "[t]he professional corporation stock cannot be liquidated or sold in a similar manner as other assets." The paragraph goes on to refer to what might happen "if the debtor were to cease practice or the corporation terminated," but does not address the possibility that the debtor might sell his practice. What the plan apparently contemplated was that Prince would continue to operate the business indefinitely, and what the creditors were seeking was some payment to his estate that would represent the value of the professional corporation apart from his personal services. If the business had not been sold, there would never have been an occasion to consider the value of Prince's personal goodwill. The case would then have been like Fitzsimmons and Cooley, where, since the debtors did not sell their businesses but continued to operate them, their "personal goodwill [was] inextricably bound up with [their] personal services and is not by operation of the earnings exception property of the estate." Cooley, 87 B.R. at 443.

It is uncertain whether the bankruptcy court believed Prince and the Creditors' Committee had decided to exclude personal goodwill from value, or on the other hand, that they had simply failed to think about the matter. For the reasons indicated above, this court finds that the plan does not reveal any mutual

intention to exclude personal goodwill as an element of value. But it does seem possible that there was no thought given to the matter, at least by the Committee. This apparent failure of the parties mutually to contemplate, or, in any event, to provide for what later happened -- a sale of the practice by Prince -- raises the question of whether the plan can be interpreted to cover valuation in the event of a sale. The provision for a judicial valuation hearing in the event the parties are unable to agree upon a value seems sufficiently unambiguous and unconditional to allow the bankruptcy court to consider any relevant evidence that pertains to "the present value of the professional corporation," whether the valuation is made in the context of a sale to a third party or not. However, this court is hesitant to hold as much on the present appeal, because there may be additional evidence the parties could offer concerning the meaning of the plan.1/

CONCLUSION

The decision of the bankruptcy court is reversed, and the case is remanded for a determination of the value of the stock in the professional corporation in light of the views expressed in this opinion. The value of Prince's personal goodwill should be included, unless additional evidence on remand supports the conclusion that Prince and the Creditors' Committee mutually intended to exclude it. As evidence of value, the bankruptcy court should consider the purchase price paid by Clare, less the value of the tangible assets and the value of the transitional services rendered by Prince in connection with the sale. The court may also consider any other relevant and admissible evidence which may be brought to its attention on remand.

Reversed and remanded.

1/ Neither does this court express any opinion as to whether the parol evidence rule, or any of its exceptions, applies to the plan.

DATED: April 10, 1991

ENTER: _____
United States District Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re	)	
	)	
DOUGLAS R. PRINCE	)	
and JANE PRINCE	)	No. 81 B 9964
	)	
Debtors	)	

MEMORANDUM OF DECISION

This Chapter 11 case is before the court for a determination of the value of stock in an orthodontic practice, pursuant to a confirmed plan of liquidation. For the reasons set forth below, I find that the stock has only nominal value under the plan, and accordingly I adopt the value of $7,500 suggested by the debtors.

FINDINGS OF FACT

The facts relevant to the decision in this case are nearly all undisputed. This case was filed on August 17, 1981, as a voluntary Chapter 11 case, by Douglas R. Prince and Jane Prince. Douglas Prince was employed as an orthodontist in his own practice, operating out of three Illinois communities. Among Dr. Prince's assets was all of the stock in the professional corporation through which he operated his practice -- Douglas R. Prince, D.D.S., M.S., Ltd. Eventually, on February 16, 1983, the Princes proposed to liquidate their estate, filing a combined disclosure statement and plan (the "Plan") expressly proposing such a liquidation. (Plan, pp. 3-4.) The Plan

was supported by the Unsecured Creditors' Committee ("the Committee"), and was confirmed on November 4, 1983.

The Plan requires the Princes to place the value of each of their non-exempt assets into a "creditors fund," from which claims would be paid. To this end, the Plan obligates the Princes either to sell each asset, or, if they chose to keep an asset, to pay its value (net of liens) into the fund. (Plan, pp. 3-4.)[1] Thus, the Plan allows the Princes to retain no equity in any of their assets beyond the exemptions provided by state law. "No claim is made for the debtor's equity or interest and no disbursements from the fund will be made to the debtor because any equity interest accrues to them in any asset." (Plan, p. 44.) The Plan sets forth the choice made by the Princes as to each of their assets -- including the stock of the professional corporation. After first describing Dr. Prince's practice, disclosing that the practice had afforded Dr. Prince "an income by salary and advance of approximately $250,000 to $300,000 per year," and valuing the assets of the professional corporation at a nominal $25,000 (Plan, pp. 18-19), the Plan notes liens on corporate assets totalling $17,500, and hence proposes to pay an equity of $7,500 into the "creditors fund," subject to audit and negotiation with the Committee. (Plan, pp. 46-47.) If the Princes and the Committee could not agree on the stock valuation, the Plan provides that the Bankruptcy Court will resolve the dispute. (Plan, p. 47.)

The Princes and the Committee have never agreed on the value of the professional corporation's stock.

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[1]If the asset is to be retained and equity exists over and above the liens, or no liens exist, the debtor, in addition to reaffirming and maintaining the liens, will be required to deposit in the creditors fund the amount of equity over and above the liens ...." (Plan, p. 26.)

However, shortly after confirmation, Dr. Prince negotiated a sale of his practice to another orthodontist, Timothy J. Clare. On February 25, 1984, the two men entered into a written agreement for the sale of the all of the stock and assets of the professional corporation for a purchase price of $450,000 or $500,000, depending on the interest rate employed. (Exhibit 23.)[2] This was consistent with a value for the corporation that Dr. Prince had declared in a personal financial statement dated March 1, 1980. (Exhibit 16.) However, the agreement with Dr. Clare imposed two conditions on Dr. Prince beyond the transfer of the stock and assets of the professional corporation. The first was a covenant not to compete, prohibiting Dr. Prince from conducting an orthodontic practice within ten miles from any of the communities in which he had practiced (Exhibit 23, ¶ 6.) The second was a "practice obligation" -- which essentially required Dr. Prince to participate with Dr. Clare in efforts to transfer his practice, remaining in the offices during a period of transition and putting forth "his best efforts and energies and ideas to promote and develope [sic] the practice" in a manner acceptable to Dr. Clare. (Exhibit 23, ¶ 15.) These two provisions had the effect of attempting to transfer Dr. Prince's personal goodwill -- the confidence that his patients had in him as an orthodontist -- to Dr. Clare. Dr. Prince, under these provisions, would both recommend that his patients

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[2]The agreement contains a fairly complicated formula for determining the amounts to be paid by the buyer: "$450,000.00 amortized at 12% simple interest for 5 years, and $500,000.00 amortized at 10% simple interest for 5 years. The payment amount shall be $120,000.00 per year including principle and interest. The balance, if any, from each of these calculations at the end of the five year period shall be averaged to obtain the final payment amount for the sixth year." (Exhibit 23, ¶ 22.)

employ Dr. Clare, and make himself unavailable to them. The issue of how much Dr. Prince is required to pay into the creditors fund for the stock of the professional corporation was not immediately presented to the bankruptcy court. Instead, Dr. Prince, Dr. Clare, and the Committee all became engaged in litigation in district court over enforcement of the sales agreement between Dr. Prince and Dr. Clare. Eventually, however, a hearing was conducted in bankruptcy court on the valuation question. Only the Committee and the Princes appeared and each relied principally on an expert witness. Both experts testified in a credible fashion, consistent with their respective assumptions. The Committee's expert concluded that the stock of Dr. Prince's professional corporation was worth $650,000, based on a capitalization of the stream of income that the practice was likely to produce in the future, but he conceded that this value would not exist in the corporation if Dr. Prince were free to compete with the corporation, and acknowledged that, without the personal goodwill of Dr. Prince, there would be only a nominal value in the corporate stock. The Prince's expert gave his opinion that the stock in fact had only nominal value, based on a liquidation analysis that concededly excluded Dr. Prince's personal goodwill.

At the conclusion of the hearing, I stated my belief that the central issue in this case was whether Dr. Prince's personal goodwill should be included in the calculation of stock value, and the parties submitted briefs on that issue. Thereafter, I issued an oral opinion and entered an order based on the conclusion that Dr. Prince's goodwill should not be a component of the valuation of the stock under the Plan. However, because of the importance of this matter to the parties, and because of the potential for appeal, I vacated this order to allow for a written decision.

CONCLUSIONS OF LAW

A. Jurisdiction.

This case involves a dispute over the implementation of a confirmed Chapter 11 plan. Because a confirmed plan is similar to a contract or consent decree, any state court of general jurisdiction can hear such a dispute. *In re Terracor,* 86 B.R. 671,680 (Bankr. D. Utah 1988) ("[The creation of the property rights conferred upon the parties by 11 U.S.C. § 1141 and the [confirmed plan] necessarily gives rise to a new and fully enforceable contract which could be interpreted by any court."). However, 28 U.S.C. § 1334(b) grants district courts concurrent jurisdiction over civil proceedings arising in or related to cases under the Bankruptcy Code (Title 11, U.S.C.) ("the Code"), and courts have held that disputes over a plan's implementation fit within this "related jurisdiction." *Terracor,* 86 B.R. at 676; *In re Franklin Corp.,* 60 B.R. 795, 802 (Bankr. E. D. Pa. 1986). Furthermore, as a matter concerning the administration of the debtor's estate, plan implementation is a "core matter" which, upon reference, a bankruptcy judge may determine on a final basis pursuant to 28 U.S.C. § 157(b)(2)(A). *In re Standard Metals,* 97 B.R. 593 (Bankr. D. Del. 1988); *Franklin, 60* B.R. at 802-03. General Local Rule 2.33 of the Northern District of Illinois refers such matters to the bankruptcy judges of this district. Therefore, I have jurisdiction to determine the value of Dr. Prince's corporate stock under the Plan.

B. The legal standard for interpreting the plan.

As noted above, a confirmed plan is similar to a

contract or consent decree. *In re L. & V. Realty Corp.*, 76 B.R. 35, 37 (Bankr. E.D. N.Y. 1987) (a confirmed plan resembles a contract); *see Official Creditor's Committee of Stratford of Texas, Inc. v. Stratford of Texas, Inc.*, 635 F.2d 365, 368 (5th Cir. 1983) (under the Bankruptcy Act, a confirmed plan is analogous to a consent decree). Accordingly, courts faced with resolving disputes over the interpretation of Chapter 11 plans have looked to principles of contract law for guidance. *Temex Energy, Inc. v. Hastie & Kirschner,* 96 B.R. 330, 332 (W. D. Okl. 1989); *L. & V. Realty Corp.*, 76 B.R. at 37; *Stratford,* 635 F.2d at 368 (as a type of consent decree, a confirmed plan should be construed as a contract).

Under contract law, the primary objective in interpretation is to ascertain the parties' intent. A. Corbin, *Corbin on Contracts* § 538 (1952); *United Airlines v. City of Chicago,* 116 Ill. 2d 311, 318 (1987). That intent, in turn, is to be gleaned, if possible, from the language of the contract itself; and, in scrutinizing the language, the entire contract must be considered. *Restatement (Second) of Contracts* § 202(2) (1979) ("A writing is interpreted as a whole."). Consequently, I must determine whether the parties intended to include Dr. Prince's personal goodwill in the value of the stock by analyzing the relevant Plan provisions as they relate to the Plan as a whole.

C. The value of the stock under the plan.

Three sections of the Plan are relevant to the question whether the stock's value should reflect Dr. Prince's personal goodwill. First, the Plan's "Preliminary Outline" states that the Plan "is conceived as essentially a *liquidating* plan" (Plan, p. 3) (emphasis added). Although nothing in the Code prevents a debtor from voluntarily contributing the value of his

personal goodwill to a Chapter 11 plan, the debtor's goodwill is not property of the estate available in an ordinary (Chapter 7) liquidation. Under the Code, the debtor creates an estate upon filing for bankruptcy which consists of "all legal or equitable interests of the debtor as of the commencement of the case" and "all proceeds, products, offspring, rents, and/or profits of or from property of the estate." 11 U.S.C. §§ 541(a)(1)(6). However, the Code excludes from the debtor's estate "earnings from services performed by the individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6). Under the personal earnings exception, personal goodwill does not enter the debtor's estate and, thus, is not liquidated. *In re Fitzsimmons,* 725 F.2d 1208, 1211 (9th Cir. 1984) (debtor's personal goodwill in his law practice is not property of the estate whereas the law practice's business goodwill is estate property); *In re Cooley,* 3 Bankr. L. Rep. (CCH), ¶72,320 (Bankr. S.D. Tex. May 20, 1989) (income stream derived from physician's personal goodwill falls under 541(a)(6)'s personal earnings exception). Therefore, given that the Plan is a "liquidating plan," Dr. Prince's personal goodwill normally would not be an asset available for creditors.

Second, the Plan provides "pertinent information concerning [the debtors'] assets," but nothing in the description of the assets hints that Dr. Prince's personal goodwill is intended to be included in these assets (Plan, p. 7.) Similarly, Dr. Prince's personal goodwill is not discussed in connection with the "pertinent" corporate assets. (Plan, pp. 18-19.) Indeed, the Plan acknowledges that Dr. Prince enjoyed an annual income of $250,000 to $300,000 from his practice in the very section where the $25,000 nominal value is assigned to the corporate stock (Plan, pp. 18-19), strongly indicating that the Plan does not consider Dr.

Prince's personal goodwill an asset to be liquidated.

Third, and most importantly, the Plan's method for valuing the stock (Plan, pp. 46-47) disregards Dr. Prince's personal goodwill. The Plan's proposed valuation method consists of three interrelated parts. First, the Plan sets out the debtors' assumptions about the assets relevant to the stock's value:

> [A] review of debtor's books has indicated that any receivables accruing to debtor as a result of a contract to provide orthodontic services over monthly or yearly periods is accompanied by the correlative obligation to perform such services. In other words, no positive equity exists to the benefit of debtor or the corporation if the debtor were to cease practice or the corporation terminated. As previously indicated, the corporation owns vehicles for which provision for payment has been made and dental equipment. The amount owing on the actual dental equipment secured by the lien of Aurora National Bank is $17,500 according to the debtor's current appraisal....

These assumptions are consistent with personal goodwill not being an element of the stock value: the only assets discussed are those that would be in existence upon the dissolution of the corporation, or its liquidation in Chapter 7 -- equipment and accounts receivable.

Next, the Plan establishes a method of valuation which incorporates these assumptions: "[D]ebtor proposes, therefore, that [the $17,500 amount owing on the equipment liens] shall be subtracted from the nominal value of the stock, to-wit, $25,000 requiring debtor to deposit $7,500 in the creditors fund for said stock." (Plan, p. 47.) This valuation formula, based on

the assumption that the receivables have no net value, simply subtracts the remaining liens from an arbitrary nominal value. There is plainly no capitalization of future earnings.

Finally, the Plan provides that "[a]n audit of the books of the corporation is currently underway" and that "[i]n the event that the debtor and the creditor s committee are not able to agree on the value of the professional corporation, it will be necessary to conduct a valuation hearing to determine the present value of the corporation." (Plan, p. 47.) In context, the contemplated valuation hearing provided by the plan would appear to have been intended to address the results of the audit, raising questions such as whether the accounts receivable really are, as the Plan assumes, offset by a correlative need for future orthodontic work, and whether any further physical assets exist. Again, there is nothing suggesting that Dr. Prince has agreed to contribute personal goodwill, or even that the Committee has suggested that he ought to do so.

The Committee views the Plan quite differently, arguing that Dr. Prince's personal goodwill is part of the equity he held in his stock, and that he cannot retain this goodwill under the Plan provisions denying him the right to retain any equity. The Committee also supports this position by reference to Section 1129(b) of the Code, the "cram down" provision. The Committee's theory is that, since the unsecured creditors are not being paid in full, Dr. Prince, as an equity holder, should be allowed to take nothing of value from the corporation, pursuant to the "fair and equitable" principle. See 11 U.S.C. §1129(b)(2)(B)(ii). These arguments cannot be accepted. As the Committee itself recognizes, the cram down provisions apply only when the plan is nonconsensual. (Committee's Brief, p. 6.) Here, the Plan was confirmed with the Committee's support. The

Committee was free to agree with the Princes on any terms that met the general requirements for confirmation, set forth in Section 1129(a) -- which does not include the "fair and equitable" test. The only relevant issue is the meaning of the terms to which the parties did agree. Plainly, the Princes agreed to take no equity in their assets, but the question remains whether Dr. Prince's personal goodwill was intended to be part of the assets of the estate subject to liquidation. For all of the reasons stated above, I find that it was not.

Since the Princes' asserted value of $7,500 is otherwise unchallenged by the Committee, I will accept it as the proper value of the stock.

CONCLUSION

For the reasons stated above, the value of the stock of Douglas R. Prince, D.D.S., M.S., Ltd. is assessed at $7500 for the purposes of implementing the Plan in this case. An appropriate order will issue.

Dated: September 15,1989

Eugene R. Wedoff
Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re	)	
	)	
DOUGLAS R. PRINCE	)	
and JANE PRINCE,	)	No. 81 B 9964
	)	
	)	
Debtors	)	

ORDER

This case coming before the court on the question of the valuation of the stock of Douglas R. Prince, D.D.S., M.S., Ltd, a hearing on the question having been held, and posthearing briefs having been submitted by the parties,

IT IS HEREBY ORDERED AND ADJUDGED, for the reasons stated in the accompanying Memorandum of Decision, that the value of the stock of Douglas R. Prince, D.D.S., M.S., Ltd, pursuant to the confirmed plan in this case, is $7500.00.

Enter: _____
Eugene R. Wedoff
Bankruptcy Judge

Dated: September 15, 1989

Supreme Court, U.S.
FILED
NOV 14 1996
OFFICE OF THE CLERK

No. 96-584

In The
SUPREME COURT OF THE UNITED STATES
October Term, 1996

DOUGLAS R. PRINCE and JANE PRINCE,
Petitioners,
v.
UNSECURED CREDITORS COMMITTEE,
Respondent.

Petition For Writ of Certiorari
To The United States Court of Appeals
For The Seventh Circuit

RESPONSE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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41 pp

QUESTION PRESENTED

Whether a business is properly valued on a going concern basis, rather than a liquidation basis, where the debtor's Chapter 11 Plan contemplates the debtor's retention of equity in the business and where the debtor intends to continue to operate the business?

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STATUTE INVOLVED

An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to set off under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to set off, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. §506(a)

INTRODUCTION

There is nothing presented by the Petition which makes this case appropriate for review. This case presents one issue: whether the stock in a professional corporation is properly valued as a going concern where a Chapter 11 Debtor retains the equity and intends to continue to operate the business. That question is conclusively answered by the Bankruptcy Code which values property in light of the purpose of the valuation and the proposed use of such property. The Bankruptcy Court, affirmed by the District Court and the Seventh Circuit, correctly applied this standard of valuation and, hence, there is no reason for review of either the appropriate standard of valuation or the application of that standard. The questions raised by the Petitioners as to ownership of covenants not to compete and goodwill are neither pertinent nor apposite to the dispute between the parties and are not properly issues before this Court.

STATEMENT OF THE CASE

On August 17, 1981, Petitioners, Douglas R. and Jane Prince (the "Princes" or "Debtors"), as husband and wife, filed their joint petition for relief under Chapter 11 of the Bankruptcy Code. (Petitioner's Appendix ("App.") at A-2) At the date of filing the bankruptcy petition, Douglas R. Prince ("Dr. Prince") was the owner of 100% of the issued and outstanding stock of a professional orthodontic practice (the "Professional Practice" or "Practice"). (Id.) Eventually, the Debtors filed a series of amended disclosure statements and plans dated October 20, 1982, November 8, 1982, and February 10, 1983. (Id.) The Amended Disclosure Statement and Plan dated February 10, 1983 (the

"Amended Plan") was ultimately confirmed on November 4, 1983. (Id.)

The Amended Plan provides, inter alia, that Dr. Prince would retain the stock of the professional corporation and continue to operate the Professional Practice. (Id.) In consideration for retaining the stock, Dr. Prince agreed to pay its value to the bankruptcy estate for distribution to creditors. (Id.) The Debtors represented in the Plan that the value of the Professional Practice was only $7,500.00. The Respondent herein, the Official Committee of Unsecured Creditors (the "Committee"), refused to accept the Debtor's valuation of the Corporation's stock. However, as a result of Debtors' negotiations with the Committee, the Plan also provides that in the event Dr. Prince and the Committee are unable to reach an agreement on the value of the Practice, that the valuation dispute would be resolved by the Bankruptcy Court. (Id.)

On February 25, 1984, Dr. Prince and another orthodontist, Dr. Timothy J. Clare ("Dr. Clare") of Orchard Park, New York, executed an agreement for the purchase and sale of the Professional Practice ("Practice Sales Contract"), inclusive of its going concern value, for a price of $450,000 or $500,000, depending on the interest rate used. (Id. at A-3) Subsequent to the signing of the Practice Sales Contract, Dr. Prince and Dr. Clare had a falling out and the contemplated sale was never consummated. (Id. at A-4)

Dr. Prince and the Committee were never able to agree on the value for the Professional Practice. (Id. at A-3) In accordance with the Amended Plan, they submitted the valuation issue for trial before the Bankruptcy Court. (Id.)

The Committee's expert witness testified that the value of the stock in November of 1983 was approximately $650,000. (Id. at A-4) The Committee's expert based his opinion upon the capitalization of cash flows that the Practice was likely to produce in the future. (Id.) The Debtor had acknowledged that the Practice had generated an annual income of between $250,000 and $300,000 annually for the Debtor. (Id.) The Committee's expert conceded that this value would not exist if the Debtor were to leave and compete with the corporation. (Id.)

Debtors' expert testified that the value of the stock of the corporation was equal to the hard assets of the practice which included the equipment and supplies. (Id.) His valuation did not include goodwill based on the absence of a restrictive covenant. The Debtor's expert did acknowledge, however, that vast majority of the practices that are sold include a restrictive covenant. (Id.)

Following the hearing, the Bankruptcy Court determined, as a matter of law, that the value of the Professional Practice was $7,500.00, exclusive of goodwill, based on the net liquidation value of the tangible assets of the Practice. (Id. at A-5) The Committee appealed the Bankruptcy Court's initial valuation determination of the Practice to the United States District Court. On April 12, 1993, District Judge John F. Grady reversed the Bankruptcy Court's decision insofar as it excluded goodwill from the valuation of the stock and remanded the case for a determination of the value of the stock with goodwill included and with consideration of the Practice Sales Contract. (Id.) The District Court found that the arm's-length sale agreement between Dr. Prince and Dr. Clare to be an accurate proxy for the value of the stock. (Id.)

On October 21, 1993, the Bankruptcy Court reopened the trial on the valuation of the Professional Practice. (Id.) At the conclusion of the hearing on October 21, 1993, the Bankruptcy Court determined that the $450,000 purchase price under the Practice Sales Contract would be reduced by the value of Dr. Prince's services due under the contract for services rendered during a "transition" period, as well as salary, housing, transportation, fuel and insurance for Dr. Clare during the same "transition" period. (Id. at A-6) Also, based upon Dr. Prince's testimony that Dr. Clare received the income from the Practice during the "transition" period, the Bankruptcy Court reduced the purchase price by a correlative amount. (Id.) Subtracting these various deductions from the price due under the Practice Sales Contract, the Bankruptcy Court set the net value of the practice at $292,290.00. (Id.) Within 10 days of the entry of judgment, the Committee moved under Fed. R. Civ. P. 59(e) to alter the judgment announced by the Bankruptcy Court asking the court to reconsider, or take additional evidence on, the various reductions it made in arriving at the value of the Practice, particularly regarding whether Dr. Prince or Dr. Clare received the income from the Practice during the "transition" period. The Bankruptcy Court found it "undisputed" that Dr. Prince and not Dr. Clare received the income of the Professional Practice for the months of February, March, April, May and June of 1984, after which time neither Dr. Prince nor Dr. Clare continued to operate the Practice. (Id. at A-7) The Bankruptcy Court then adjusted its previous deductions and arrived at a valuation of the Professional Practice of $405,440.00, inclusive of good will, and entered a final order. (Id.)[1]

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[1]This is the final order from which the Petitioners are actually appealing. In contravention of Supreme Court Rule 14(h)(i), the Petitioners have failed to include both the Bankruptcy Court's Final

The Princes appealed this final order to the United States District Court contending that the Bankruptcy Court abused its discretion in granting the Committee's Motion to Alter Judgment under Rule 59 of the Federal Rules of Civil Procedure. (Id. at A-7) District Court Judge Suzanne B. Conlon affirmed the Bankruptcy Court's order, finding that the Bankruptcy Court had not abused its discretion in reopening the proofs and amending its judgment in order to prevent injustice, correct a manifest error of fact, and correct a judgment based on Dr. Prince's "false testimony". (Supp. App. at 9.)

The Princes filed separate appeals from both District Court Judge Conlon's decision affirming the Bankruptcy Court's order granting the Committee's Motion to Alter Judgment and District Court Judge Grady's decision remanding the case back to the Bankruptcy Court for a determination of the value of the stock including goodwill. The two appeals were consolidated for hearing and decision before the United States Court of Appeals for the Seventh Circuit.

The Court of Appeals affirmed both decisions of the District Court. First, the Court of Appeals held that proper valuation of stock as an asset is determined by "its ability to generate cash flows in the future." (App. at A-8) The Court determined that, in the absence of guidance from the

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Order and the District Court's Memorandum Opinion and Order dated September 1, 1994 affirming that Order, as part of their Appendix. Parenthetically, the Committee notes that the failure to include the order appealed from in and of itself is sufficient reason for the Court to deny the Petition. See Supreme Court Rule 14.4. To assist the Court in a full understanding of the proceedings below, copies of these two orders are attached hereto as a Supplemental Appendix (hereinafter "Supp. App.").

parties, goodwill should be included in the valuation of stock. (Id. at A-7) This analysis is changed when the business in question is to be liquidated, rather than continued as an ongoing concern. In the former case, liquidation value is appropriate; in the latter, goodwill is to be included as part of the business' future anticipated income stream:

> In dissolution, liquidation distributions are the only foreseeable future cash flows to the shareholder, and thus liquidation value is an accurate tool for measuring the stock's value. On the other hand, where a business is expected to continue as a going concern, the company's expected future earnings from operations often far exceed the liquidation value of the company's physical assets. Thus, when valuing a business that is continuing to operate as a going concern, liquidation value is generally an inaccurate approximation of what shares are worth to the shareholders.

(Id. at A-11 (citations omitted)) It is undisputed that the Debtors were planning to continue operating the Practice at the time the Amended Plan was approved. Finding that the factual consequences hinging upon whether goodwill is treated as part of the value of the stock were undisputed, the Court of Appeals affirmed the decisions of the District Court and the Bankruptcy Court as to the value of the stock.

Second, the Court of Appeals affirmed the District Court's finding that the Bankruptcy Court properly exercised its discretion in granting the Committee's Rule 59(e) motion to alter or amend the judgment. (Id. at A-18 - A-21) The Petitioners have not taken exception to the Court of Appeals'

decision as to this issue and, accordingly, it has been waived. Supreme Court Rule 14.1(a).

REASONS FOR DENYING THE WRIT

I. THE DECISIONS BELOW CORRECTLY VALUED THE STOCK ON A GOING-FORWARD, RATHER THAN LIQUIDATION, BASIS.

Respondent respectfully opposes the Petition for Writ of Certiorari, which, as the old saying goes, would "confuse a riot." The Petition seeks review of two issues which have no bearing on the ultimate disposition of this case--whether a bankruptcy estate owns the goodwill and covenants not-to-compete of a bankrupt professional. Rather, the sole issue presented below was the proper valuation of stock in the debtor's hands at the time of the filing of the bankruptcy petition where the debtor intended to retain the equity and continue operating the corporation. Such valuation must, of course, be made on a going-forward basis rather than a liquidation basis in light of the Debtor's plans to continue operating the business after confirmation.

This is the analysis the Seventh Circuit affirmed below and is consistent with the Bankruptcy Code's approach to valuation of property:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to set off under

> section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to set off, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. §506(a)(emphasis added). The legislative history of §506(a) indicates that when valuing property, "Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case." H.R. Rep. No. 95-595 at 356, 5 U.S. Code Cong. & Admin. News at 6312. Valuation of property under the Bankruptcy Code must, therefore, focus on (1) the purpose for which the valuation is being a performed and (2) the proposed disposition or use of the property. These two factors are to be weighed on a case-by-case basis. Id.

Respondent readily acknowledges that §506(a) was intended to determine the extent to which a specific creditor is secured or unsecured during a bankruptcy case, an issue currently not before the Court. However, the approach taken by the Bankruptcy Code to valuation is consistent both with the approach to valuation taken in other, non-bankruptcy contexts and with the approach to stock valuation taken by the Seventh Circuit in the decision below. (See App. at A-8 (wherein the Seventh Circuit cited Richard A.

Brealey & Stewart C. Myers, Principles of Corporate Finance 29-68 (4th ed. 1991)) Thus, the Seventh Circuit succinctly set forth the Bankruptcy Court's duties in valuing the Petitioners' stock in this case:

> The bankruptcy court's task was not to determine the present value of the stock as of some hypothetical future day when Dr. Prince left to compete with his own corporation, but to determine the value of the stock on the day the bankruptcy reorganization plan was confirmed. Present value is derived by discounting back a projected stream of future cash flows, and this stream of cash flow projects is based on the probability of possible future events.

(App. at A-11 - A-12)(emphasis added) Happily for the Bankruptcy Court, the discounting of the "projected stream of future cash flows" had already been performed by the Petitioners when they had agreed to sell the Professional Practice to Dr. Clare.

The facts of this case demonstrate why the Seventh Circuit correctly applied the going concern method of valuation, rather than valuing the stock on a liquidation basis. The Petitioners agreed in the Amended Plan, confirmed November 4, 1983, to pay the **value** of the stock to the bankruptcy estate in return for the right to continue to operate the Professional Practice. Prince did continue to operate the business and, less than four months later, attempted to sell the practice for at least $450,000. As all three courts below found, the stock of the practice was worth approximately $450,000 at the time the Amended Plan was confirmed, since that is the amount that a ready, willing and

able buyer was willing to pay for the Professional Practice. In any event, the undisputed facts demonstrate that the Professional Practice was worth far more than the $7,500 the Debtors proposed to pay to the bankruptcy estate.

In similar circumstances, other courts have refused to allow debtors to assign a low value to their assets when dealing with creditors and then aggregate to themselves a substantially higher fair market value for the same assets when dealing with third parties:

> The interpretation championed by [the debtor] renders the second sentence of §506(a) virtually meaningless. Moreover, it would allow a reorganizing debtor to reap a windfall by stripping down the lien to liquidation value and quickly selling the collateral at fair market value, thus pocketing equity that would have been completely beyond reach save for the filing of the bankruptcy petition. Cf. Butner v. United States, 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed. 2d 136 (1979)(bankruptcy law should "prevent a party from receiving a windfall merely by reason of happenstance of bankruptcy").

In re Winthrop Old Farm Nurseries, 50 F.3d 72, 76 (1st Cir. 1995). The Princes have offered no reason as to why their stock should be given a higher value to everyone except their creditors. In fact, none exists. Id.[2]

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[2]Indeed, the facts would indicate that the Princes believed that the result they wished to achieve would be inequitable vis-a-vis the Committee, since the Princes conspired to keep the impending sale of the Practice to Dr. Clare a secret from the Committee. (Supp.App. at 1-2)

In sum, the Seventh Circuit, the District Court and the Bankruptcy Court correctly valued the stock as a going concern. This was the only question that was presented below. Moreover, the method of valuation was neither unique nor remarkable. In fact, the method used was entirely consistent with the approach taken elsewhere in the Bankruptcy Code and by courts interpreting the Code. The Committee notes that the Petitioners have failed to cite any authority for the proposition that the method used for valuation of the stock was inappropriate. Plainly, there is nothing presented by this case which would warrant this Court's review.

II. THE PETITIONERS HAVE FAILED TO CORRECTLY FRAME THE ISSUE IN THIS CASE AND, THUS, HAVE FAILED TO OFFER A COGENT REASON FOR THE GRANTING OF A WRIT OF CERTIORARI.

At bottom, the Petitioners are attempting to divert this Court's attention away from the real issue in the case in order to create a controversy where none exists. As is demonstrated above, the issue in this case is the proper valuation of stock in a professional corporation where the debtor intends to continue to operate the corporation. Rather than addressing this issue, the Petitioners frame the issue differently, claiming that the question posed is whether a bankruptcy estate "owns" the professional goodwill of (or, put differently, possesses an implied covenant not-to-compete from) the debtor. The Petitioners further assert that there is a split among the circuits on this issue.

Unfortunately for the Petitioners, this issue is irrelevant to the decision from which they appeal. The question of a covenant not-to-compete never arose since Dr. Prince never intended to compete with the Practice. Accordingly, the issue of the "ownership" of a non-existent covenant not-to-compete was never decided. As the Seventh Circuit observed, the extremely remote possibility of Dr. Prince leaving the Practice and competing elsewhere was a factor which could be taken into account in valuing the stock:

> On the day the plan was confirmed, Dr. Prince's leaving the competing with the corporation was hardly a 100 percent certainty. It was a possible event that affected the value of the stock: the higher the probability of him competing, the lower the expected future cash flows to the stock, and the lower the probability of him competing, the higher the expected future cash flows to the stock.

(App. at A-12) All parties to the Amended Plan assumed that Dr. Prince would not go out and compete against himself, despite the absence of a covenant not-to-compete and, thus, the possibility of Dr. Prince competing against the Practice could be discounted to zero:

> However, it is not clear that the probability of him leaving and competing was any higher than zero despite the absence of a covenant not to compete. At the time the plan was confirmed, Dr. Prince was operating the practice, and it seems quite unlikely that while still owning the stock he would have

> abandoned his practice, moved across the street, and competed with himself.

(Id.) To put it bluntly, the valuation of the stock is entirely independent of the existence of a covenant not-to-compete at the time of the plan because Dr. Prince intended to keep the corporation operating as a Professional Practice. Whether Dr. Prince could have abandoned his Practice prior to the time of the Amended Plan and compete with his former professional corporation, and whether the bankruptcy estate would have owned a restrictive covenant arising therefrom, may be interesting questions; they are questions, however, not presented by the facts of this case.

Since this case never presented the questions of "ownership" of covenants not-to-compete or of goodwill, the Petitioners' argument that there is a split of authority as to ownership of covenants not to compete can be ignored. The issue was not addressed by the Seventh Circuit and has never been part of this case. Accordingly, this question does not present adequate grounds for the granting of the Petition.

Moreover, the Petitioners are mistaken in asserting that there is a "split" among the circuits on this (irrelevant) question. Only the Fourth Circuit has addressed this issue, and the Fourth Circuit found that lower courts (save one) have consistently found such a covenant to be part of the bankruptcy estate. See In re Andrews, 80 F.3d 906, 911-12 (4th Cir. 1996). Thus, even if this question were relevant to this case (which it is not), there is no "split of authority" which would warrant review.

Further, the Petitioners' contention that the Seventh Circuit's decision ignored Illinois law holding goodwill to be a personal attribute misses the mark. The Petitioners have

failed to cite any authority for the proposition that professional goodwill cannot be valued as part of stock or transferred to another party. In fact, the one case the Petitioners do cite, In re Marriage of Zells, 143 Ill. 2d 251, 254, 572 N.E.2d 944, 946 (1991), recognizes that professional goodwill can be valued in divorce proceedings based upon a professional's ability to generate income.[3] This is precisely the manner in which goodwill was valued with respect to Dr. Prince's stock. (App. at A-16) The Seventh Circuit, in fact, went further: it noted a distinction between the "goodwill" which was a personal attribute of Dr. Prince and the "goodwill" which was inherent in the value of the Professional Practice. (Id. at A-16 - A-17) The former could not be transferred nor taken into account in valuing the stock:

> In an important sense, however, Dr. Prince's goodwill is unlike his skills, his schooling, or his dental license. These components of Dr. Prince's human capital can only manifest their value by increasing the worth of his future labors. Dr. Prince's innate physical ability, his personality, or his professional degree increased the market value of his services, but they cannot be sold to another orthodontist; they have value only as attributes of Dr. Prince.

(App. at 1-16) Thus, the Seventh Circuit recognized that

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[3]In Zells, the Illinois Supreme Court held that professional goodwill should not be valued as a discrete marital asset, but rather as part of a spouse's income potential. Id., 572 N.E.2d at 946. The Zells decision does not state that a professional's good will is incapable of being transferred.

certain aspects of goodwill are, indeed, personal attributes and cannot be transferred. Other aspects of goodwill do have value apart from a person and can be transferred--as Dr. Prince recognized when he tried to sell the Practice and his goodwill to Dr. Clare. Accordingly, the Seventh Circuit properly took this type of transferrable goodwill into account when valuing the stock. This holding is consistent with Illinois law.

Finally, the Committee notes that under the Bankruptcy Code, as with all instances of the valuation of property, valuing is to be done on a case-by-case basis. The Seventh Circuit correctly applied the appropriate method of valuing the Debtors' stock in this case. There are no compelling reasons why the Seventh Circuit's decision should be reviewed or overturned in this case, nor does this case present issues of such overriding concern that review is necessary to establish precedents for use in other cases. Accordingly, the Committee submits that this case does not constitute an appropriate matter for this Court's review.

CONCLUSION

The sole question presented by this case is the proper valuation method for Dr. Prince's stock. The decision on review correctly valued that stock on a going-concern basis, based on the purpose for which the stock was being valued and the debtor's intended use after confirmation. This method is the generally accepted method for valuing stock and is consistent with the approach set forth in the Bankruptcy Code for valuing assets. On this issue, the only issue in this case, there is no split of authority. The Petitioners have failed to demonstrate that the stock should

be valued in a different manner. Rather, the Petitioners have focused on questions which are not germane to the facts of this case. No compelling reasons have been presented for granting a writ of certiorari in this matter and, accordingly, the Petition should be denied.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re	)	
	)	
DOUGLAS R. PRINCE and JANE PRINCE,	)	**Case No. 94 C 3341**
	)	
	)	
Debtors.	)	**Judge Suzanne B. Conlon**

MEMORANDUM OPINION AND ORDER

A bankruptcy judge entered a final order valuing Douglas Prince's ("Dr. Prince") Illinois orthodontic practice at $405,000. Debtors Douglas and Jane Prince appeal the judgment to this court. 28 U.S.C. § 1334 (a).

BACKGROUND

The essential facts are undisputed. Dr. Prince is an orthodontist who filed Chapter 11 bankruptcy with his wife on August 17, 1981. On November 7, 1983, the bankruptcy court approved a reorganization plan under which the Princes were to sell certain assets. The plan allowed Dr. Prince to retain his orthodontic practice, but he was required to pay creditors the value of the practice over a period of years. If Dr. Prince and the unsecured creditors' committee (the "creditors' committee") did not agree on a value for the practice, the plan provided that the value would be determined by a bankruptcy court after a hearing.

On February 25, 1984, Dr. Prince agreed to sell his orthodontic practice to Dr. Timothy Clare, an orthodontist from New York. Dr. Prince neither informed the creditors'

committee of the sale nor told Dr. Clare that he was in bankruptcy, although both parties soon discovered the respective information. Dr. Clare was to begin making payments in September 1984. Between February 25 and September 4 (the "interim period"), Dr. Prince agreed to work at the practice several weeks per month, to be responsible for all debts of the practice, and to pay Dr. Clare a salary of $500 for each day Dr. Clare worked in Dr. Prince's office. Arm's length negotiations between Dr. Prince and Dr. Clare resulted in a contract price of $450,000 for sale of the practice.

Dr. Prince, however, used a different method of valuation in his negotiations with the creditors' committee. Dr. Prince maintained to the committee that the only value of the practice after he left were its tangible assets, or $7,500. The committee sought a valuation of $450,000. After a trial on the issue, the bankruptcy court determined that the value of the practice was $7,500 exclusive of goodwill, which the court held was an inappropriate factor to be used in valuation. The creditors' committee appealed the finding; a district court reversed the bankruptcy court's decision and remanded for a valuation that included goodwill.

Upon remand, the creditors' committee moved for summary judgment on a valuation of $395,769.23, representing the difference between the contract price and the value of Dr. Prince's "transitional services" during the interim period. On August 7, 1993, the bankruptcy court granted summary judgment. The Princes appealed; a district court again remanded the case, this time to adduce additional evidence.

On October 21, 1993, the bankruptcy court reopened the valuation hearing. The court accepted various forms of

evidence, including testimony by Dr. Prince and Dr. Clare that the $450,000 contract price overstated the value of the practice. The bankruptcy court then closed the proofs and heard final arguments. The Princes argued that the valuation of the practice should be offset by salary, housing, transportation, and other benefits paid by Dr. Prince to Dr. Clare during the interim period in which Dr. Prince acclimated Dr. Clare to the practice. During this argument, it dawned upon all three parties that a crucial issue was whether Dr. Prince or Dr. Clare received the income from the orthodontic practice during the interim period. Oct. 21, 1993 Transcript ("Tr.") 147. The parties and the court agreed that if Dr. Clare received the income from the practice during the interim period, then Dr. Prince would be entitled to an offset for the value of his services. If, however, Dr. Prince received the income, an offset would be improper. Rather than "leav[ing] this as an open issue," the bankruptcy court, without adjourning, recalled Dr. Prince to testify as to which doctor received the income from the practice until September 4. Dr. Prince testified that Dr. Clare received the income. Believing that this contradicted the apparent intent of the written contract, the court noted that Dr. Clare was to be paid $500 per day in salary and that Dr. Prince remained responsible for rent until September 4. Oct. 21, 1993 Tr. 153. Nevertheless, Dr. Prince maintained that Dr. Clare received the income, and Dr. Prince's counsel admonished the court not to "second-guess" the parties' actions. Oct. 21, 1993 Tr. 154. The creditors' committee objected that Dr. Prince's testimony did not comport with the apparent intent of the contract. However, the bankruptcy court, having no other evidence, resolved the issue with some hesitancy:

> All right. I guess the best I am going to have on this is the testimony I have heard. I think it's somewhat at odds with the apparent intent

> of this document. But on the other hand, I don't have any testimony to refute what you are saying, Dr. Prince. So I am going to accept that. I will accept that Dr. Clare received the income from this enterprise from the September [sic] 25 date forward. It's the best evidence I have at this point.

Tr. 157.[1]

The bankruptcy court concluded that the $450,000 practice valuation would be reduced by the value of Dr. Prince's services, as well as the salary, housing, transportation, fuel, and insurance for Dr. Clare. The net value of the practice was set at $292,290.

Within ten days after entry of the judgment, the creditors' committee moved to alter the judgment or, in the alternative, to reopen the proofs and take additional evidence. R. 8. In support of its motion, the creditors' committee directed the bankruptcy court to provisions of the sales contract, a handwritten letter from Dr. Prince to Dr. Clare, deposition testimony given by Dr. Prince in 1984, Dr. Clare's testimony at the original valuation hearing in 1988, and Dr. Clare's 1984 deposition testimony. R. 8; R. 11, p. 5. These proffers contradicted Dr. Prince's testimony that Dr. Clare received the income from the orthodontic practice during the interim period. Faced with conflicting evidence, the court, before ruling on the motion, granted the creditors' committee leave to obtain bank records maintained in the

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[1]The reference to "September 25" appears to be an error. The bankruptcy court probably meant "February 25," the effective date of the sale contract for the orthodontic practice.

name of the orthodontic practice. R. 11, p. 6. After reviewing the records, the bankruptcy court granted the motion of the creditors' committee to alter the judgment, finding it "undisputed that the bank records confirm that Dr. Prince and not Dr. Clare received the income of the Professional Practice for the months of February, March, April, May, and June of 1984, after which time neither Dr. Prince nor Dr. Clare continued to operate the Professional Practice." R. 11, p. 6. The bankruptcy court then adjusted its previous deductions, arrived at a valuation of $405,440 inclusive of goodwill, and entered a final order.

In this appeal, the Princes argue that the bankruptcy court abused its discretion by granting the motion of the creditors' committee to amend the October 21, 1993 valuation finding.

DISCUSSION

The sole issue on appeal is whether the bankruptcy court properly granted the motion of the creditors' committee to alter judgment under Fed. R. Civ. P. 59. A grant or denial of a Rule 59 motion is reviewed for abuse of discretion. Souter v. International Union. United Auto. etc., Local 72, 993 F.2d 595, 599 (7th Cir. 1993). Rule 59 motions are generally used to correct a manifest error of law or fact, or to consider newly discovered evidence that could change the result of a proceeding. Souter, 993 F.2d at 599; Federal Deposit Ins. Corp. v. Meyer, 781 F.2d 1260, 1268 (7th Cir. 1986). These factors, however, are not themselves dispositive. Rather, they are animated by the court's duty to ensure substantial justice, and are markers designed to alert the court when justice is likely to be compromised. See 11 C. Wright & A. Miller, Federal Prac. & Procedure, § 2803 (1973 & Supp. 1994); Guinan v. United States, 6 F.3d 468,

470 (7th Cir. 1993); Juneau Square Corp. v. First Wis. Nat'l Bank, 624 F.2d 798, 806 n.11 (7th Cir. 1980); cf. Fryman v. Federal Crop Ins. Corp., 936 F.2d 244, 251 (6th Cir. 1991). Thus, when a Rule 59 motion is denied despite newly discovered evidence or a manifest error of law or fact, the losing party has an argument for abuse of discretion because the new evidence or articulation of error suggests that justice may have been compromised. On the other hand, a party appealing the grant of a Rule 59 motion because the prevailing party was able to convince the court that the result was unjust, albeit without the benefit of newly discovered evidence or manifest error, has a more difficult burden. The ultimate question is whether the court, in its discretion, believes that injustice has somehow infected the judgment.

The Princes make only one argument: The bankruptcy court abused its discretion in opening the judgment because the creditors' committee could have obtained the bank records prior to the October 21, 1993 hearing and avoided Dr. Prince's "erroneous" testimony. One problem with this argument is that the Princes themselves could have obtained the bank records prior to the hearing and avoided Dr. Prince's "erroneous" testimony. The fact that the records were not produced during the hearing confirms that neither party understood that the income stream would be an issue. Only during final argument colloquy did the parties realize the importance of the issue. This left the Princes with an advantage because only they had a ready source of evidence to address the issue: Dr. Prince. Dr. Prince's testimony was wrong. Any attempt by the Princes to uphold this false testimony in light of "undisputed" proof to the contrary must be rejected.

In any event, the Princes' argument misses a more fundamental point. Although the bankruptcy court did not

elaborate on its reasons for altering judgment beyond opining that it would be "inappropriate" to bar the creditors' committee from showing that Dr. Prince 's testimony was patently false, it is reasonable to infer that the bankruptcy court granted the motion of the creditors' committee in the interest of justice. Neither the committee nor the Princes presented evidence at the October 21, 1993 hearing as to which doctor received the income from the practice during the interim period. The creditors' committee, the Princes, and the bankruptcy court realized that this issue was important only during closing arguments and after the proofs were closed. R. 11, p. 3-4. Because the bankruptcy court could not accurately value the practice without an answer to the income stream question, the court reopened the proofs for the limited purpose of allowing Dr. Prince, who happened to be present, to testify on the issue. R. 11, p. 4. Dr. Prince testified that Dr. Clare received the income. Over objection of the creditors' committee, the court accepted Dr. Prince's testimony despite its own misgivings. Tr. 157. Within days of the hearing, the creditors' committee sifted through voluminous documents and other information accumulated throughout this litigation's 14-year life and discovered several pieces of evidence that cast doubt on Dr. Prince's income-stream testimony. In light of this evidence, the bankruptcy court directed the creditors' committee to obtain bank records to resolve the issue conclusively. The bank records confirmed that Dr. Prince received the income during the interim period. The bankruptcy court then admitted the bank records into evidence and adjusted its valuation to reflect that Dr. Prince and not Dr. Clare had received the income.

The Princes objected to this action, and the bankruptcy court therefore was presented with a choice. It could reopen the proofs and reach a correct result or it could

knowingly enter an erroneous judgment giving Dr. Prince a $105,000 windfall as a result of his own false testimony. The bankruptcy court did not abuse its discretion by choosing the first option.

Aside from this "interest of justice" rationale, the bankruptcy court's action was proper in two other respects as well. First, the bankruptcy court's decision to admit the bank records into evidence corrected a manifest error of fact. Rule 59 motions are properly used to correct manifest errors of fact. Souter, 993 F.2d at 599. Likewise, a court may grant a new trial or otherwise alter a judgment if that judgment is based on false testimony. See Antevski v. Volkswagenwerk Aktiengesellachaft, 4 F.3d 537, 540 (7th Cir. 1993). Both of these tenets apply in this case. Here, the creditors' committee made a substantial proffer that Dr. Prince received the income from the practice, and bank records later demonstrated that fact conclusively. This evidence put the bankruptcy court on notice that it had made a factual error by finding that Dr. Clare received the income. Similarly, the motion of the creditors' committee alerted the bankruptcy court that Dr. Prince, whether by accident or design, had given factually inaccurate testimony. Because the bankruptcy court relied heavily on this testimony to value the practice, it did not abuse its discretion by opening the judgment to correct its error.

Finally, the bankruptcy court's action was sanctioned by Rule 59(a). The motion of the creditors' committee to alter the judgment alternatively asked the bankruptcy court to reopen the proofs and take additional evidence. In effect, the motion alternatively asked for a new trial on the income-stream issue. Rule 59(a) provides:

> On a motion for a new trial in an action tried without a jury, the court may open the judgment if one has been entered, take additional testimony, amend findings of fact and conclusions of law or make new findings and conclusions, and direct entry of a new judgment.

Because the valuation hearing was tried without a jury, the court was empowered to grant a new trial on any aspect of the issues "for any of the reasons for which rehearings have heretofore been granted in suits in equity in the courts of the United States." F.R.C.P. 59(a). The bankruptcy court's decision to admit the bank records into evidence may properly be viewed as granting the Rule 59(a) motion of the creditors' committee. The bankruptcy court considered the new evidence and modified its conclusions of fact accordingly. Moreover, the Princes were not prejudiced. The bankruptcy court offered them an opportunity to contest the authenticity and interpretation of the bank records at a March 17, 1994 hearing. See March 17, 1994 Tr. 2-20.

Thus, whether the bankruptcy court modified the valuation to correct a manifest error of fact, because the valuation was based on false testimony, or because justice required the modification, the bankruptcy court did not abuse its discretion by revaluing Dr. Prince's enterprise.

CONCLUSION

The judgment of the bankruptcy court is affirmed.

ENTERED:

/s/ Suzanne B. Conlon
Suzanne B. Conlon
United States District Judge

September 1, 1994

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re	)	**Chapter 11**
	)	
DOUGLAS R. PRINCE	)	**Case No. 81 B 09964**
and JANE PRINCE,	)	
	)	
Debtors.	)	**Hon. Eugene R. Wedoff**

ORDER GRANTING THE MOTION
OF THE UNSECURED CREDITORS' COMMITTEE
TO ALTER OR AMEND JUDGMENT

This matter was heard by the court on the motion of the Unsecured Creditors' Committee (the "Committee") to alter or amend the judgment of this court dated November 18, 1993 which order determined the value of the professional orthodontic practice of Douglas R. Prince ("Dr. Prince") to be in the amount of $292,290, inclusive of Dr. Prince's goodwill. The court makes the following findings:

1. On August 17, 1981, Douglas R. and Jane Prince (the "Princes"), as husband and wife, filed their joint petition for relief under chapter 11 of the Bankruptcy Code.

2. At the date of the filing initiating the bankruptcy case, Dr. Prince was the owner of a professional orthodontic practice operated under the name of Douglas R. Prince D.D.S., M.S., Ltd. (the "Professional Practice" or "Practice").

3. On November 7, 1983, the Princes' Amended Plan of Reorganization (the "Plan") was confirmed by this court.

4. The Plan provides, in part, for the Princes to turn over certain assets to a liquidating and disbursing agent for sale or disposition.

5. The Plan also provides for the Princes to retain certain other assets, including the stock of the Professional Practice and to pay their creditors the value of the retained assets over a period of years. The Plan is silent as to the method to be used to determine the value of the Professional Practice, but does provide for the court to resolve valuation disputes in the event Dr. Prince and the Committee are unable to agree.

6. On February 25, 1984, Dr. Prince and another orthodontist, Dr. Timothy J. Clare ("Dr. Clare"), of Orchard Park, New York, entered into an agreement for the purchase and sale of the Professional Practice ("Practice Sales Contract"), inclusive of its going concern value, for a then present value price of $450,000, paid by Dr. Clare to Dr. Prince. Apparently, neither the buyer nor the seller consulted with counsel prior to signing the agreement.

7. Subsequent to the signing of the Practice Sales Contract, Dr. Prince and Dr. Clare had a falling out, described in Prince v. Zazove, 959 F.2d 1395 (7th Cir. 1992).

8. Because Dr. Prince and the Committee were unable to agree on the value for the Professional Practice, they submitted the valuation issue for trial before the bankruptcy court. At the conclusion of the trial, this court determined as a matter of law that the value of the

Professional Practice was $7,500, not including the personal goodwill of Dr. Prince, based upon the net liquidation value of the tangible assets.

9. The Committee appealed the valuation determination to the United States District court. On April 12, 1993, District Court Judge John F. Grady reversed the bankruptcy court's decision insofar as it excluded goodwill from the valuation and remanded the case back to this court for a determination of the value of the Professional Practice with goodwill included by reference to the Practice Sales Contract. (127 B.R. 187 (N.D. Ill. 1991).)

10. After remand, the Committee filed a motion for summary judgment in which it stipulated that the value of the Professional Practice, solely for the purpose of the motion, was $395,769.23, representing the difference between $450,000 and value of Dr. Prince's transitional services under the Practice Sales Contract. The Princes contested the Committee's motion and offered certain affidavits and interrogatory answers filed by Dr. Clare in opposition.

11. On August 7, 1993, the bankruptcy court granted the Committee's summary judgment; and the Princes appealed.

12. At the request of the Committee, the Princes' appeal was reassigned to Judge John F. Grady, who reversed the order granting summary judgment and remanded the case back to the bankruptcy court.

13. On October 21, 1993, this court reopened the trial on the valuation of the Professional Practice to take additional evidence pursuant to the mandate of the district court.

14. The Princes presented the testimony of both Dr. Prince and Dr. Clare in support of their contention that the Practice value was less than the $450,000 value stated in the Practice Sales Contract.

15. However, neither the Princes nor the Committee offered any evidence as to whether Dr. Prince or Dr. Clare was entitled to the income generated by the Professional Practice between the date of the signing of the Practice Sales Contract on February 25, 1984 until September 20, 1984, the date when Dr. Clare was to commence making installment payments to Dr. Prince as set in the Contract (the "Interim Period").

16. During post hearing argument after the proofs were closed, the Princes argued that the value of the Practice should be reduced by the value of personal services provided by Dr. Prince to the Practice during the Interim Period, by the value of certain benefits provided to Dr. Clare (car, house etc.) during the Interim Period, and by the salary paid to Dr. Clare during the Interim Period. The Princes advanced the theory that the amount of these obligations, which were set forth in the Practice Sales Contract, reduced the consideration to be paid to Dr. Prince by Dr. Clare.

17. This court determined that Dr. Prince's arguments could not be properly evaluated unless it was established whether Dr. Prince or Dr. Clare actually received the income from the Practice during the Interim Period. This court concluded that if Dr. Prince received the income and used it to pay these obligations under the Practice Sales Contract, a setoff might not be in order; however, if Dr. Clare received the income, then Dr. Prince's personal obligation to make these payments from his own assets and personally perform services would be an offset against the

purchase price. Thereupon, this court reopened the proofs solely to allow Dr. Prince to testify as to whether he or Dr. Clare was entitled to the income generated by the Professional Practice between February 25, 1984 and September, 1984. Dr. Prince testified that it was Dr. Clare who was entitled to the Professional Practice income during this period.

18. After considering Dr. Princes's testimony on this point, this court found that Dr. Clare was entitled to the revenue for the Professional Practice during the Interim Period. Therefore, the court further determined that the value of Dr. Prince's services and the payments made by Dr. Prince for Dr. Clare's salary and expenses reduced the amount to be paid to Dr. Prince by Dr. Clare under the Practice Sales Contract and accordingly reduced the value of the Professional Practice.

19. Specifically, this court ruled on October 21, 1993 that the $450,000 value of the Professional Practice was to be reduced by the following:

a. $112,500 for the value of Dr. Prince's services, to be rendered after signing of the Practice Sales Agreement;

b. $7,200 for housing provided to Dr. Clare;

c. $360 for gasoline provided for Dr. Clare;

d. $7,000 for travel expenses allowed to Dr. Clare;

e. $650 for payment of professional liability insurance for Dr. Clare; and

f. $30,000 of salary paid to Dr. Clare.

20. On November 9, 1993, the Committee moved to alter this court's October 21, 1993 ruling, insofar as the determination of value deducted the amounts enumerated in paragraph 19 above. In support of its motion, the Committee directed the court's attention to specific provisions of the Practice Sales Contract itself, to a hand-written letter from Dr. Prince to Dr. Clare, to Dr. Prince's deposition taken in Prince v. Clare, 84 C 7694, to Dr. Clare's testimony at the original valuation hearing held on November 10, 1988, and to the transcript of Dr. Clare's deposition taken in Prince v. Clare, 84 C 7694. Alternatively, the Committee requested that if this court was not inclined to alter or amend the judgment, that it reopen proofs, to take the additional evidence offered by the Committee on this point.

21. The Princes objected to the Committee's motion to alter the judgment, arguing that the court should not consider the additional evidence offered by the Committee in the Motion to Alter. However, it would be inappropriate to refuse to reconsider the matter and other relevant and probative evidence on the issue of whether Dr. Clare or Dr. Prince received the income from the Professional Practice after signing of the Practice Sales Contract. Accordingly, this court offered the Committee the opportunity to obtain relevant bank records to establish conclusively, in the face of conflicting testimony on the point in the record, whether Dr. Prince or Dr. Clare received the income from the Professional Practice after signing the Practice Sales Contract.

22. Based upon the court's direction, the Committee obtained the bank records from an account maintained in the name of the Professional Practice at the Bank of Naperville for the period in question. The parties have reviewed these records and it is undisputed that the bank records confirm that Dr. Prince and not Dr. Clare received the income of the Professional Practice for the months of February, March, April, May and June of 1984, after which time neither Dr. Prince nor Dr. Clare continued to operate the Professional Practice.

23. Based upon these records, all of the other evidence presented by the Committee on the point, and the additional evidence offered by Dr. Prince at a subsequent hearing held on April 1, 1994, this court concludes as follows:

a. That the Practice Sales Contract was signed by the parties on February 25, 1984, and the Professional Practice was to remain in the name of and operated for the benefit of Dr. Prince until a closing on the transfer, on September 4, 1984.

b. That the amount of $450,000 was the value of the Professional Practice fixed by Dr. Clare and Dr. Prince in arms length negotiations, which amount was considered by them to be the value of the Practice on September 4, 1984.

c. That the total net amount to be paid by Dr. Clare to Dr. Prince, pursuant to the Practice Sales Contract, was $450,000.

d. That, during the period from February 25, 1984 until September 4, 1984, pursuant to the Practice Sales Contract, Dr. Prince was to receive for his own benefit the income generated by the operation of the Professional Practice.

e. The Practice Sales Contract contemplates that the amount actually received by Dr. Prince for the sale of the Professional Practice to Dr. Clare would be reduced by the following amounts:

(1) $30,000 of salary to be paid to Dr. Clare;

(2) $7,200 for the value of Dr. Clare's housing;

(3) $7,000 for travel expenses of Dr. Clare; and

(4) $360 for gasoline expenses for Dr. Clare's vehicle.

Total **$44,560**

24. Based upon these findings, and the applicable law, this court therefore grants the Committee's Motion To Alter Judgment. Based upon the record of this case and the applicable law, this court determines that the value of the Professional Practice, for purposes of this proceeding and the Amended Plan of Reorganization, is $405,440, inclusive of goodwill.

25. This is a final order of the Bankruptcy Court which determines all remaining valuation issues.

BY THE COURT:

/s/ Eugene R. Wedoff
UNITED STATES BANKRUPTCY JUDGE

Dated: 4/12/94 Effective 4/14/94

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Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

DOUGLAS R. PRINCE and
JANE PRINCE,

Petitioners,

v.

UNSECURED CREDITORS COMMITTEE,

Respondent.

Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Seventh Circuit

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

Respondent's response in opposition unfortunately obfuscates that which is involved and is disingenuous.

This Petition involves that portion of a decision by the Seventh Circuit affirming a decision by the United States District Court dated April 10, 1991 (A25-40) *reversing* and remanding the Bankruptcy Court decision of September 15, 1989 (A41-50) which held the stock involved to be worth $7,500. That District Court decision as to the value of the stock directed:

> "The value of Prince's personal goodwill should be included". (A-39)

That was issue number 1 in the Court of Appeals. (A-6) No other District Court or Bankruptcy Court decisions are involved in this petition. The issue was in no way dependent on 11 U.S.C. §506(a) stated to be the statute involved in Respondent's reply. Respondent's attempt to frame the issue as going-concern value versus liquidation value was not what was involved in the decisions and issues below and is not herein involved.

The Seventh Circuit noted that the parties agree that if Dr. Prince's goodwill is excluded from the valuation calculus, the worth of the stock is limited to $7,500. (A-8) The experts of both parties agreed that the stock would not be worth more absent the professional corporation holding a covenant not to compete from Dr. Prince which it is agreed was not held. (A-4). Otherwise the stock would be worth $405,440 which is what a third party Dr. Clare offered to pay for the hard assets *plus* a 5 year covenant not to compete after certain nonconsequential deductions. (A-3, 6-7, 8). The Seventh Circuit adopted that later figure as the stock's value. (A-11). In so doing the Seventh Circuit had to attribute the good will as represented by the value of the covenant not to compete in Dr. Clare's post-bankruptcy contract as the value of Dr.

Prince's goodwill while he was with the corporation when it was in bankruptcy. In so doing, the Seventh Circuit stated:

> "On the other hand, Dr. Prince's goodwill, like the practice's physical equipment, can be sold and transferred, and once sold and transferred can generate value for another orthodontist. Although the mechanism of using his best efforts to transfer his patient's loyalties to Dr. Clare and then securing the transaction with a covenant not to compete is not as simple as signing over title to a physical asset, the functional effect is the same. Dr. Prince could sell and deliver his goodwill to Dr. Clare and Dr. Clare would then reap the value of the asset. Thus, Dr. Prince's goodwill is not intrinsically part of his human capital, but rather is a separate tangible capital asset of the practice, like a trademark would be." (A-17).

The language then refers to footnote 5 which states as follows:

> "Note that the mere fact that Dr. Prince's goodwill was created through years of his practicing in the community does not alter the conclusion that it is an asset separate from his human capital. If Dr. Prince were to have fashioned one of the practice's physical assets with his own hands, this would not change the fact that the asset could be sold and, therefore, that the asset had value independent of Dr. Prince. The earnings exception does not exclude earnings from an asset created by a debtor's past labors, only the earnings from actual services performed by the debtor in the *future.*" (A-17)

The Seventh Circuit concludes:

> "The value of Dr. Prince's goodwill represents future cash flows not from the earnings for future services actually performed by Dr. Prince,

> but from return on an intangible asset that could be sold and transferred with the sale of the practice."

Thus according to the Seventh Circuit, a professional's goodwill is like a piece of meat or a machine owned by a bankruptcy estate and subject to sale. The asset can be secured with a covenant not to compete.

Respondent says this is an issue pertaining only to Dr. Prince. It is obvious that this is an issue pertaining to every professional.

Respondent says that this is in accord with the Illinois Supreme Court in *In re Marriage of Zells*, 143 Ill. 2d 251, 572 N.E. 2d 946. (1991) That is untrue. The recent Illinois Supreme Court case of *In re the Marriage of Talty*, 166 Ill. 2d 232 at 238-40, 652 N.E. 2d 330 at 333-4 (1995) cites *Zells* as holding "goodwill represents merely the ability to acquire future income", and that that case involved a professional practice wherein goodwill is generally personal to the professional, and the case went on to make the following distinction: to the extent goodwill inheres in the business, existing independently of the individual's personal efforts, and will outlast his involvement with the enterprise, it should be considered as an asset of the business, and, in contrast, to the extent that goodwill of the business is personal to the individual, depends on his efforts and will cease when his involvement ends, it should not be considered property (it is income generating ability that goes with the person). In this case, the experts on both sides agreed that the stock was not worth anything over the $7,500 in physical assets absent a restrictive covenant with Dr. Prince. The reason was that Dr. Prince could leave his one-man professional corporation and open across the street and his patients would follow for it was he that they went to for treatment. And it is clear that Dr. Prince had no restrictive covenant. Thus under Illinois law the goodwill belonged

to Dr. Prince, personally. It was his personal ability to generate income. It was his human capital. Forcing a professional to purchase his own personal goodwill as being part of a corporation's stock value was taking away what the professional personally owned and charging the professional for his own income generating ability as being a corporate asset contrary to the holdings of the Illinois Supreme Court as well as the future earnings exemption of 11 U.S.C. §541(6). Just because personal goodwill can be transferable by transition services and covenants not to compete does not change its nature.

In this context, the petition referred to ownership of the covenant not to compete, meaning, as the cases and national text cited, the post-petition proceeds from such covenant. Respondent is correct that this case is not a fight over proceeds from a covenant not to compete and that the Seventh Circuit does not deal with such ownership. However, Judge Grady in the District court raised the subject because the sale of stock to Dr. Clare which the District court used as the benchmark for the value of Dr. Prince's goodwill was a sale of stock with a covenant not to compete and Judge Grady stated that a covenant not to compete would not be considered within the earnings exemption of 11 U.S.C. §541(6) for future earnings from services because such earnings were for nonservices. (A-35-36). That is the subject of the conflicts addressed in petitioners' petition which respondent states are not involved in this case. The Fourth Circuit cited the *Prince* District Court opinion in this case as support for its view which was that of Judge Grady in *In Re Andrews*, 80 F. 3d 906 at footnote 14 and the opposite conclusion is drawn by the 5th Circuit in *Matter of Walden*, 12 F. 3d 445 at footnote 12. The dispute involves various courts on both sides. However, petitioner does acknowledge that

such a dispute is merely tangential to the *Prince* case. It is addressed only by the District court.

The most serious issue is the treatment of the personal good will of a professional as separate from the professional and as an intangible asset of a corporation, an asset that asset subject to sale in bankruptcy, whereas it is a part of a debtor's future earning capacity. If a debtor chooses to sell part of that future earning capacity as a covenant not to compete, it is true that it can be severed, but is the debtor who has that right to sell a part of his future earning capacity and that does not alienate the debtor's goodwill from his earning capacity. Respondent's position that this is a non-issue because personal goodwill can be transferred does not warrant the conclusion that the petition for the writ should not be granted because that could lead, as here, to professionals having to purchase part of their future earning capacity, their personal goodwill, to use that earning capacity and to have part of their future earning capacity be subject to being part of the bankruptcy estate subject to sale to others which violates the future earnings exemption under 11 U.S.C. §541(6) and ignores Illinois law holding what is involved to be future earning capacity.

Dated: November 25, 1996

Respectfully submitted,

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